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SWIFT *v.* TYSON AND SOME CONSIDERATIONS OF PHILOSOPHY IN AMERICAN LAW

*Urban R. Miller**

It is too early for exhaustive *post mortems* on *Swift v. Tyson.*[1] We should remember that notwithstanding all the attacks made upon the doctrine, it held sway for nearly a hundred years, and its demise in 1938 was quite unexpected by the Bar. Thousands of cases, involving hundreds of millions of dollars, were manipulated back and forth between federal and state courts with ethical indifference, in attempts either to avoid the rule on the one hand or to come within it on the other. The doctrine's own self-exploitation was the result of a constant and ever-widening accumulation of precedent under such practice. Its ramifications will not be fully appraised for years to come, at least not until many of the questions which were adjudicated under the rule prior to 1938 are brought up and readjudicated.

Comprehensive, however, as the majority opinion in *Erie v. Tompkins*[2] appears to be, it is conceivable that a great many of the cases decided under *Swift v. Tyson* will stand. It has already been suggested that the rule in *Erie v. Tompkins* will not likely be carried to the logical end marked by the first sentence of the opinion.[3] Its application will undoubtedly be tempered by concession here and there to sound precedent. The present Court is thoroughly aware of the unhappy result flowing from the exacting absolutism of *Swift v. Tyson.*

As Maitland said of the historian, and as law writers have said of particular fields of the law, one who seeks to exhaust the ramifications of *Swift v. Tyson* is "tearing a seamless web". *A fortiori* it would be idle to attempt to analyze, or even to surmise,

*Williams, Arizona. Member of the Iowa and Arizona Bars.

[1]16 Pet. 1, 10 L. ed. 865 (U. S. 1842).

[2]58 Sup. Ct. 817, 82 L. ed. 787 (1938) [overruling Swift v. Tyson, 16 Pet. 1 (U. S. 1842)].

[3]Powell, *The Constitutional Convention and Swift v. Tyson* (1938) 25 A. B. A. J. 862. Erie v. Tompkins virtually limits the jurisdiction of federal courts to cases involving the Constitution and laws and treaties made thereunder.

the probable and possible influence of *Erie v. Tompkins* in many fields. Only time, and the adjudication of new situations differing nevertheless here and there from every set of facts assembled under *Swift v. Tyson,* will combine to resolve what is now moot, largely speculative.

However, since we are now at the threshold of some implications which equilibrate from fundamental principles, observations on such questions are not untimely. These will be directed, first, to political consideration of the recurring conflict between the Constitution and the Court, and philosophical analysis of inconsistency in our law and the idea of dominance of standard of conduct by a single governmental institution or a single rule of law. Closely akin to these three propositions is practical consideration of the utility of the doctrine in *Swift v. Tyson* in uniformizing the law merchant in diversified sovereign states.

If such a discussion *per se* suggests inconsistency, it should be remembered that in spite of its ramifications *Swift v. Tyson* provided no tightly interwoven *unit* of law. The philosophy that a thing's antithesis grows out of the thing itself may function here to demonstrate in analysis some fallacies of *Swift v. Tyson* and *Erie v. Tompkins,* as well as the sound features of the underlying doctrines.

However, it cannot necessarily be said that such a philosophy could account for any natural changes in our law to bring uniformity out of inconsistency. *Stare decisis* in law is too obstinate in its own course of direction, and bad precedent is more prolific than good precedent. There is little of pure negation in bad precedent; too often it is more positive than good precedent. And either may be used, without regard to uniformity or consistency, merely as a stop-gap for a waning tide of thought.

The Unconstitutionality of the Course Pursued by the Court in Swift v. Tyson

The expedient adopted by the Court in *Erie v. Tompkins,* namely, taking gratuitous cognizance of the unconstitutionality of the course pursued by the federal courts under the rule in *Swift v. Tyson,* raises an interesting question: Can the Supreme Court of the United States perform an unconstitutional act or pursue an unconstitutional course?

The familiar doctrines of separation of powers and checks and balances give the Court the paramount dominion. The executive and legislative branches are amendable to judicial legislation by the Court. Individual members of the Court are held accountable

only for their judicial ethics, and that by the process of impeachment. They are not even answerable to popular will. Except only insofar as a justice permits his individual political philosophy so to construe the oath of office, is he obliged to sense the national pulse.

Proponents of the doctrine that the Court should be more adaptable to contemporary social philosophies are undoubtedly encouraged by the Court's tacit admission that it pursued an unconstitutional course for nearly a hundred years. And they should be nonetheless encouraged by the like admission that a deciding factor of some weight was the extra-constitutional consideration of the political and social defects attributed to the rule.[4] This was likewise assumed by the Court without the point having been argued in the case at bar. These grounds for overruling *Swift v. Tyson* are particularly significant by virtue of the fact that the rule in *Swift v. Tyson* only sharpened the bewildering uncertainties surrounding the important fields of state and federal judicial legislation.[5]

The controversy over the respective functions of state and federal governments within a given field is one that came out of the Constitutional Convention itself, and has become more involved with the advance of time. We would naturally look to two governmental processes for a clearer definition of this scope of federal and state dominion within a given field. The first is by constitutional amendment. But as often has been the case, the fate of such proposals as could have clarified the question may have been subordinated to the traditional pragmatism of those with a vested interest in some phase of the *status quo*. In addition, the Court exercises some dominion over the very adoption of a constitutional amendment, as was first definitely assumed in the liquor cases.[6] This is inherent in the power to pass upon the constitutional validity of the proposal and ratification of an amendment.

The second is by the simple expedient of judicial definition, construction and interpretation. That the Court assumed to function in this respect in *Swift v. Tyson* there is no doubt. But that it only expanded and confused the issue there is no less doubt.

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[4]See Erie v. Tompkins, 58 Sup. Ct. 817 (1938).

[5]2 WARREN, THE SUPREME COURT IN UNITED STATES HISTORY (rev. ed. 1935) 89. In Erie v. Tompkins the Court quoted, on this point, the following from Warren: "Probably no decision of the Court has ever given rise to more uncertainty as to legal rights; and though doubtless intended to promote uniformity in the operation of business transactions, its chief effect has been to render it difficult for business men to know in advance to what particular topic the Court would apply the doctrine. . . ." *Ibid.*

[6]National Prohibition Cases, 253 U. S. 350 (1921); Dillon v. Gloss, 256 U. S. 368 (1921); United States v. Sprague, 282 U. S. 716 (1931).

When the significance of *Swift v. Tyson* was presently recognized, it was suggested that the Court had occupied a field of legislation that not even Congress could occupy.[7] Plainly Congress is without the power to legislate in the field of general law.[8] The limitation is not one on Congress alone under the scheme of checks and balances, *but is one imposed upon the whole federal government itself.* If the question prematurely framed in *Swift v. Tyson* had been properly at issue, the Court would not have erred in commanding jurisdiction to pass upon it, since a diversity of citizenship was involved. And sooner or later the question would have been presented anyway. But the Court erred by preempting for the federal judiciary law-making power prohibited to the federal government by the Constitution, when the case might have been resolved by a virtual self-denying decision applying the law of New York—the place where the acceptance contract was made by the defendant, the place of defendant's residence, and the state of the forum. Thus was completed the rather unusual proceeding where the Court had jurisdiction of the parties, amplified its jurisdiction of subject-matter to resolve the controversy in terms of its own discretion, and conferred upon itself a power prohibited to the very government of which it is a part.

So apparently in *Erie v. Tompkins* the Court sought to obviate for all future time the mischief attendant upon such a doctrine as that promulgated in *Swift v. Tyson.* Although the Court recognized that the researches of Mr. Charles Warren conclusively established its erroneous construction in *Swift v. Tyson* of Section 34 of the Federal Judiciary Act of 1789,[9] the decision in *Erie v.*

[7]Lane v. Vick, 3 How. 464 (U. S. 1845). Accord: Erie v. Tompkins, 58 Sup. Ct. 817, 82 L. ed. 787 (1938). See also Dobie, *Seven Implications of Swift v. Tyson* (1930) 16 VA. L. REV. 225; Hornblower, *Conflict Between Federal and State Decisions* (1880) 14 AM. L. REV. 211. However, the implications of the matter go even further. Since Congress had no power to legislate in such a field prohibited to the federal government it was as powerless to change the federal common law set up in the forbidden field by the federal judiciary. Madison's notes on the debates in the Constitutional Convention show, by the following extract therefrom, that the Convention so interpreted its acts: "The following motion was disagreed to, to-wit: 'In all the cases before mentioned the judicial power shall be exercised in such manner as the Legislature shall direct.'" Powell, *supra* note 3, at 862.

[8]U. S. CONST. Art. I, § 8; Tenth Amendment.

One is reluctant to speculate whether Mr. Justice Reed would have it said that the language used in his concurring opinion in Erie v. Tompkins indicates a doubt on this point. He may have had reference to "federal statutory direction" within *accepted* Constitutional fields. But further on he used the same unqualified language in his analysis of the main opinion. At page 799 of 82 L. ed. he said: "If the opinion commits this Court to the position that the Congress is without power to declare what rules of substantive law shall govern the federal courts, that conclusion also seems questionable."

[9]Warren, *New Light on the History of the Federal Judiciary Act of 1789* (1923) 37 HARV. L. REV. 49.

Tompkins was founded principally upon the more basic question of the *unconstitutionality of the course pursued by the Court.*[10]

In view of the unfortunate course of *Swift v. Tyson* through our history, some words of Chief Justice Hughes are impressively significant. He said, "The Constitution is what the Court says it is."[11] In *Swift v. Tyson* the Court held that in cases involving diversity of citizenship federal courts could apply their own rules of decision in the field of general law, without regard to any prior decisions on the question at bar by a state court of the forum. In scores of subsequent decisions the scope of the field of general law was widened to encompass an ever-increasing array of subjects,[12]

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[10]"Thus the doctrine of Swift v. Tyson is, as Mr. Justice Holmes said, 'an unconstitutional assumption of powers by courts of the United States which no lapse of time or respectable array of opinion should make us hesitate to correct.'" 82 L. ed. 787, 793.

However, Mr. Justice Reed in his special concurrence suggests a less complex ground for overruling Swift v. Tyson than the "unconstitutionality of the course pursued" by the Court. He would reinterpret the words "the laws" as used in Section 34 of the Federal Judiciary Act of 1789 to ". . . include in their meaning the decisions of local tribunals." *Id.* at 799. This would involve merely an admission by the Court that in Swift v. Tyson it misinterpreted Section 34 of the Judiciary Act. But in anticipation of Justice Reed's reasoning, the Court said: "If only a question of statutory construction were involved, we should not be prepared to abandon a doctrine so widely applied throughout nearly a century . . . ." *Id.* at 792. On this Hon. Robert H. Jackson argues that the decision in Swift v. Tyson cannot be explained by terming it a mere misconstruction of Section 34 of the Judiciary Act. Jackson, *The Rise and Fall of Swift v. Tyson* (1938) 24 A. B. A. J. 609.

As a matter of fact, Erie v. Tompkins is not the first case in which the Court has recognized the error in one of its decisions. On this point see Mr. Justice Brandeis' opinion in Burnet v. Coronado Oil & Gas Company, 285 U. S. 393, 406-410 (1932). The difference is only in the relativity of the admissions. Heretofore they have been made rather parenthetical, almost argumentative. But in the most recent instance we have a confession, explicit and straightforward, without any attempt at rationalization. In this instance penitence is manifest in the spirit of a present eagerness to right a wrong.

[11]These words are attributed to him in 1907 at Elmira, New York, when he was Governor of New York.

See also United States v. Butler, 297 U. S. 1, 79 (1936), wherein Mr. Justice Stone remarked, ". . . . The only check upon our own exercise of power is our own sense of self-restraint."

[12]Rowan v. Runnels, 5 How. 134 (U. S. 1847) (in the face of an intervening *contra* construction of a clause of the Mississippi constitution by the Mississippi court, the Supreme Court refused to alter its own prior decision construing the same clause of the Mississippi constitution); Chicago v. Robbins, 2 Black 418 (U. S. 1863) (application of federal law to private rights growing out of construction of municipal ordinance); Yates v. Milwaukee, 10 Wall. 497 (U. S. 1871) (in opinion by Mr. Justice Miller, who was a strong dissenter from application of the doctrine, the Court disregarded state rule in adjudicating a conflict between municipal action and rights of a riparian owner); N. Y. C. R. R. v. Lockwood, 17 Wall. 357 (U. S. 1873) (on ground that question was one of general commercial law, Court went contrary to state law and applied federal rule that carrier cannot stipulate for exemption from responsibility for its own negligence); Boyce v. Tabb, 18 Wall. 546 (U.

to disregard state statutes on matters purely intraterritorial in nature,[13] and to malign state courts' construction of state consti-

S. 1873) (Court disregarded decision by Louisiana court based upon the public policy of that state with reference to the subject-matter of the contract in question); Hough v. Texas & P. R. R., 100 U. S. 213 (1880) (followed federal rule on question of master and servant; an identical state rule not necessarily followed, but was merely coincident with federal rule); L. & G. W. Steam Co. v. Phenix Ins. Co., 129 U. S. 397 (1889) (although admiralty and maratime jurisdiction vested in federal courts by Art. III, Sec. 2, of the Constitution, Court brought it within rule of Swift v. Tyson by interpreting it as general mercantile law); Lake Shore & M. S. R. R. v. Prentice, 147 U. S. 101 (1893) (in absence of express local statute, right of common carrier to contract for exemption from liability for own negligence one of general law); B. & O. R. R. v. Baugh, 149 U. S. 368 (1893) (question of responsibility of railroad company for injuries caused by act of its servants one of general law); Gardner v. Michigan C. R. R., 150 U. S. 349 (1893) (responsibility of railroad company to employees one of general law); Beutler v. Grand Trunk Junction R. R., 224 U. S. 85 (1912) (decision by Mr. Justice Holmes holding that where no settled rule of property intervenes, determination of who are fellow servants is question for federal court); Baltimore & Ohio v. Goodman, 275 U. S. 66 (1927) (standard of conduct; opinion by Mr. Justice Holmes); Black & W. Taxicab & Transfer Co. v. Brown & Y. Taxicab & Transfer Co., 276 U. S. 518 (1928) (disregarded motive in reincorporating in another state to provide diversity of citizenship); Pokora v. Wabash R. R., 292 U. S. 98 (1934) (standard of conduct); Eels v. St. L., K. & N. W. R. R., 52 Fed. 903 (C. C. S. D. Iowa 1892) (stipulation by carrier for exemption from liability a matter of general law); Keene Five Cent Sav. Bank v. Reid, 123 Fed. 221 (C. C. A. 8th, 1903) (in spite of intention of parties as expressed in promissory note that note should be construed by laws of Kansas, it was held that construction of note was matter of general law upon which federal court should be guided by its own rule of decision. See, however, dissenting opinion, 123 Fed. 227, 232); Yeates v. I. C. R. R., 137 Fed. 943 (C. C. N. D. Ill. 1905) (question of liability for negligence as between lessor and lessee of railway track one of general law); Curtis v. C. C. C. & St. L. R. R., 140 Fed. 777 (C. C. E. D. Ill. 1905) (in the absence of state statute on subject, question of liability of lessor railroad company for negligence of lessee one of general law); Johnson v. Charles D. Norton Co., 159 Fed. 361 (C. C. A. 6th, 1908) (contract of guaranty a commercial contract, and federal courts not bound to follow state decisions not based on state statutes); Norfolk & P. Traction Co. v. Miller, 174 Fed. 607 (C. C. A. 4th, 1909) (question of liability of carrier for exemplary damages for wanton conduct of servant toward passenger one of general law); Fowler v. Pennsylvania R. R., 229 Fed. 373 (C. C. A. 2nd, 1916) (validity of contract between sleeping car company and servant one of general law and not to be determined by law of state where accident happened); Cole v. Pennsylvania R. R., 43 Fed. (2d) 953 (C. C. A. 2nd, 1930) (state decisions as to railroad company's liability for fire negligently started not rule of property and therefore question to be determined by federal rule of decision); Greene v. Keithley, 86 Fed. (2d) 238 (C. C. A. 8th, 1936) (allowance of exemplary damages a matter of general law; no question of interstate commerce involved). See also Sharp & Brennan, *The Application of the Doctrine of Swift v. Tyson Since 1900* (1929) 4 IND. L. J. 367.

[13]Lane v. Vick, 3 How. 464 (U. S. 1845) (federal court not bound by state court's construction of will devising land); Foxcroft v. Mallet, 4 How. 353 (U. S. 1846) (decisions of state court controlled by common law construing mortgage not conclusive upon federal court); Williamson v. Berry, 8 How. 495 (U. S. 1850) (federal court's construction of private act of New York Legislature concerning trusts under will); Watson v. Tarpley, 18 How. 517 (U. S. 1856) (question of sufficiency of notice and protest not controlled by state statute, but one of general commercial law); Gelpcke v. Dubuque, 1

tutions.[14] The course pursued in *Swift v. Tyson* committed the Court to a doctrine from which it recognized the necessity of retreating,[15] but under the sanctity of precedent hesitated to do so.[16] The Court had spoken; the Constitution was not merely interpreted but was amended.[17]

Whether the Court upholds or invalidates, reshapes or modifies, it is presumed that the course it pursues is constitutional. In theory who can deny the presumption? And yet it took the Court a hundred years to confess the unconstitutionality so apparent from the outset. It can hardly be said that by the absence of popular

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Wall. 175 (U. S. 1864) (where decisions of Iowa Supreme Court on constitutionality of statute were overruled by later state decisions, Supreme Court of United States not bound to follow latest state adjudications); Burgess v. Seligman, 107 U. S. 20 (1883) (on ground that question was one of general law, federal court not bound to follow state statute as to stockholder's liability); Barber v. Pittsburgh, Ft. W. & C. R. R., 166 U. S. 83 (1897) (decision by state court in former action in ejectment not conclusive as adjudication of rights of parties in federal court); Kuhn v. Fairmont Coal Co., 215 U. S. 349 (1910) (federal court followed own rule on question of subjacent support); Messinger v. Anderson, 171 Fed. 785 (C. C. A. 6th, 1909) (no duty devolving upon federal court to follow decision of state court in construction of will); Knox & Lewis v. Alwood, 228 Fed. 753 (D. C. S. D. Ga. 1915) (construction of will or deed does not establish rule of property and therefore question of general law); Midland Valley R. R. v. Sutter, 28 Fed. (2d) 163 (C. C. A. 8th, 1928) (questions of character of right-of-way granted interstate railroad and rights of adjoining fee owner determined by principles of general law and federal courts not bound by local decisions); Midland Valley R. R. v. Jarvis, 29 Fed. (2d) 539 (C. C. A. 8th, 1928) (question as to character of interstate railway right-of-way one of general law); Mid-Continent Petroleum Corp. v. Sauder, 67 Fed. (2d) 9 (C. C. A. 10th, 1933) (state court's construction of oil lease not binding on federal court).

[14]Rowan v. Runnels, 5 How. 134 (U. S. 1847); Graves v. Slaughter, 15 Pet. 449 (U. S. 1841); Gelpcke v. Dubuque, 1 Wall. 175 (U. S. 1864) (see, however, Mr. Justice Miller's dissenting opinion); Riggs v. Johnson County, 6 Wall. 166 (U. S. 1869) (see, however, Mr. Justice Miller's dissenting opinion); Butz v. City of Muscatine, 8 Wall. 575 (U. S. 1869) (see, however, Mr. Justice Miller's dissenting opinion).

[15]Particularly Mr. Justice Miller's dissenting opinion in Gelpcke v. Dubuque, 1 Wall. 175, 209 (U. S. 1864): "Thus we are to have two courts, sitting within the same jurisdiction, deciding upon the same rights, arising out of the same statute, yet always arriving at opposite results, with no common arbiter of their differences. There is no hope of avoiding this, if this court adheres to its ruling."

[16]See notes 12, 13 and 14, *supra*.

[17]See Jay Burns Baking Co. v. Byran, 264 U. S. 504, 534 (1924), wherein Mr. Justice Brandeis, with Mr. Justice Holmes concurring, said that the Court was assuming to "exercise the powers of a super legislature—not the constitutional function of judicial review." Also the following: "The Supreme Court is not only a court of justice, but in a qualified sense a *continuous constitutional convention*. It continues the work of the Convention of 1787 by adapting through interpretation the great charter of government, and thus its duties become political, in the highest sense of that word, as well as judicial." JAMES M. BECK, THE CONSTITUTION OF THE UNITED STATES (1936) 221.

dissent through constitutional amendment the Court was justified in accepting its ruling as unquestioned.

The heart of the whole proposition can conveniently be summed up in the question: "Whose prerogative is it to determine whether the Court has pursued an unconstitutional course?" Theoretically only the Court is endowed with the power. That, however, does not preclude exercise of the most sacred franchise of a free people —public lay dissemination of opinion on political wisdom, constitutionality, public policy and expediency. While a superficial and cumbersome check on the Court's fidelity to the Constitution is provided by means of constitutional amendment, popular expression in any manner is an unsatisfactory substitute for the lack of wisdom in judicial interpretation.[18] No complacent faith in a requisite majority vote approaching unanimity could supply that illusory thing called popular wisdom. It would only encumber the process further. However, popular expression through amendment is the only constitutional substitute we know. Dialectic judicial wisdom is more expedient and sound than any procedure adopted as a substitute for lack of judicial wisdom.

Carry our analysis as far as we may, and we are always confronted by the striking anamoly that although the Court *can* pursue an unconstitutional course, the remedy therefor is only through a process in turn circumscribed by judicial interpretation.

Uniformity in Diversity of Citizenship Cases

The doctrine in *Swift v. Tyson* was an attempt at fulfillment of the desire for uniformity. On this point Mr. Justice Story Americanized Cicero's reasoning, and quoted: "*Non erit alia lex Romae, alia Athenis, alia nunc, alia posthac, sed et apud omnes gentes, et omni tempore, una eademque lex obtinebit.*"[19] And no more commendable reasoning could have been adopted. The need for coördination, and its utility, are constantly in evidence.[20] In

[18]As a matter of fact, the Constitution has been amended only three times to overcome decisions of the Court: The Eleventh Amendment was adopted to overrule Chisholm v. Georgia, 2 Dallas 419 (U. S. 1793); the Thirteenth, Fourteenth and Fifteenth Amendments were adopted to destroy the pernicious philosophy of the Dred Scott decision [Scott v. Sandford, 19 How. 393 (U. S. 1857)]; the Sixteenth Amendment was adopted to correct the result of Pollock v. Farmers Loan & Trust Company, 158 U. S. 601 (1895). With the process of amendment so difficult of achievement in any event, and the country, with the exception of probably a minority of the Bar, largely unaware of the result of Swift v. Tyson, what chance at ratification would a proposed amendment to correct Swift v. Tyson have had?

[19]Swift v. Tyson, 16 Pet. 1, 19 (U. S. 1842). But *cf.* GRAY, NATURE AND SOURCES OF THE LAW (2d. ed. 1927) 253, cited Jackson, *op. cit. supra* note 10, at 610.

[20]"The injustice and confusion incident to the doctrine of Swift v. Tyson have been repeatedly urged as reasons for abolishing or limiting diversity of citizenship jurisdiction." 82 L. ed. 787, 792.

this, however, *Swift v. Tyson*, as a precedent, succeeded too well, as for instance, by extension of the doctrine to encompass a thing so general and dogmatic as standard of conduct.[21] So at the same time the caprice of the Bar in manuevering for the shelter of state or federal courts, as best fitted one side of the particular case, and without accountability to any well-defined rules of jurisdiction, became the very antithesis of uniformity. Here, as in many other fields of American jurisprudence, the utility of consistency and orthodoxy, not only in a philosophy of law, but in its application, has been obvious.

Apprehension as to the disintegrating tendency of controversies between citizens of different states, especially in the early years of the republic, caused the framers grave concern.[22] But it was also recognized that to agree in detail in a constitutional compact on the comprehensive questions so presented would be a herculean, if not an impossible, task. Simultaneously the problem was complicated by the natural refusal of the states to surrender dominion over the field of general law. So the powers of Congress[23] and the jurisdiction of the federal judiciary[24] were limited. This resulted in more than a compromise; it became undeniably fundamental; inalienable except upon the most profound consideration. Article III of the Constitution is respectful of Articles I and II, and all are circumspect by the Tenth Amendment. And so uniformity was primarily relegated to the diversified jealousies of the states. Section 2 of Article III became explanatory, not expansive, at the expense of any uniformity extending beyond its accepted field.

As was repeatedly suggested, Section 34 of the Judiciary Act complacently reiterates what would have been the rule in the ab-

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[21]B. & O. R. R. v. Goodman, 275 U. S. 66 (1927). See also Southern Pacific Co. v. Berkshire, 254 U. S. 415 (1921).

[22]While, as pointed out herein, the rule in Swift v. Tyson was predicated upon the ideal of uniformity, in practice it failed miserably. This was due to the more basic irreconcilable theories of "states rights" in jurisprudence. As elsewhere pointed out, "Philosopher's writings and law-men's doings meet rarely on the same level of discourse . . . ." Llewellyn, *On Philosophy of American Law* (1934) 82 U. OF PA. L. REV. 205. If they did meet "on the same level of discourse" in Swift v. Tyson, there was, as we might put it more simply, too wide a gap between theory and practice. On this ideal of uniformity our jurisprudence is but a patchwork of incoherency.

HAMILTON, THE FEDERALIST, No. 88; Friendly, *The Historic Basis of Diversity Jurisdiction* (1928) 41 HARV. L. REV. 483. Accord: United States v. Texas, 143 U. S. 621 (1892).

[23]U. S. CONST. Art. I, § 8.

[24]U. S. CONST. Art. III, § 2.

sence of legislative definition.[25] The jurisdiction of state courts is left undiminished by both the Act and the interpretations that the Act is surplusage. Thus by the undue expansiveness of *Swift v. Tyson* the judiciary involved itself in the stormy controversy over the dividing line between state and federal powers. Being so involved, and on the defensive to justify its intrusion, it must have been at times incapable of a judicious appraisal of the situation.

If the impelling need behind *Swift v. Tyson* was an extension of uniformity beyond the deficiencies of Section 2 of Article III, we would naturally expect *Erie v. Tompkins* to provide, if constitutionally possible, something more fundamental and far-reaching in the way of uniformity. But in this *Erie v. Tompkins* fails, not necessarily of its own deficiencies, but because of (1) the constitutional limits exceeded by *Swift v. Tyson* and now acknowledged; (2) the adjectival defects inherent in the rather arbitrary statutory limitation of federal jurisdictional amount in diversity of citizenship cases;[26] (3) reluctance or inability of the states to collaborate effectively for uniformity within their fields of dominion.

The anomalies involved in the first obstruction to uniformity have already been discussed. The remedy of liberal but careful adaptation of judicial legislation to dialectic social tenets at first appears to be merely an irresponsible didactic criticism. Some would say that we tried that in the unconstitutional course pursued in *Swift v. Tyson*. But that is not exactly what we did. There is a vast difference in social utility between progressive judicial expansion of the Constitution to meet gradual but imperceptible social changes, and outright judicial amendment. The former has been accepted, almost unquestioned, since *Gibbons v. Ogden*.[27]

Under federal statute, diversity of citizenship cases are divided into two classes: (1) those in which the amount in litigation is less than three thousand dollars, and (2) those in which the amount in litigation is more than three thousand dollars.[28] Cases within the first class have not been triable in federal courts since 1911.[29]

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[25]Bank of Hamilton v. Dudley, 2 Pet. 492 (U. S. 1829); Hawkins v. Barney, 5 Pet. 457 (U. S. 1831); Mason v. United States, 260 U. S. 545 (1923); *cf.* Jackson *ex dem.* St. John v. Chew, 12 Wheat. 153 (U. S. 1827); Livingston v. Moore, 7 Pet. 469 (U. S. 1833).

[26]Rev. Stat. § 629 (1875), 28 U. S. C. § 41 (1937); Davis v. Mills, 99 Fed. 39 (C. C. Conn. 1900); Symonds v. St. Louis & S. F. Ry., 192 Fed. 353 (C. C. Ark. 1911). That this is purely an arbitrary provision, one has only to trace its history from the Federal Judiciary Act of 1789, wherein the jurisdictional amount was $500, through the amendment of 1888 raising the amount to $2,000, down to the amendment of 1911 fixing the amount at $3,000.

[27]9 Wheat. 1 (U. S. 1824). Accord: McCulloch v. Maryland, 4 Wheat. 316 (U. S. 1819).

[28]Rev. Stat. §§ 563, 629 (1875), 28 U. S. C. § 41 (1937).

[29]*Ibid.*

And there is usually more than one available state forum for the trial of these cases.[30] Many of them are therefore subject to the discordant laws of two or more sovereign states.[31] So the manipulation of jurisdiction of parties, together with all the attendant chicanery, is dependent upon the vagaries of the substantive and adjective law of the available state forums. Since the curtailment of federal jurisdiction by the jurisdictional amount statute,[32] these cases have not been subject to the conflicts between federal and state laws, but to the conflicts between diverse state laws.

Cases within the second class, the upper strata, are no longer subject to the conflicts between federal and state laws, as they were under *Swift v. Tyson.* They are now subject only to the conflicts between state laws, just as are cases coming within the first class, except that application of the laws of the state finally chosen by the litigant in the most favored position in this respect, is made by the federal court.[33]

Erie v. Tompkins has therefore not struck at the root of the evil. But by eliminating the dominance of the so-called federal common law, it has put all diversity of citizenship cases, whether triable in federal or state courts, on the same footing of heterogeneous state laws. And the purely arbitrary section 41(1) of the Judicial Code is at last wholly justified on the ground of the convenience of the overcrowded federal courts,[34] since no substantive rights of the litigants are now involved in removals from state to federal courts or *vice versa.*

A well-directed criticism of *Erie v. Tompkins* is that the state courts will now lose the salutary influence and help of the federal courts in the struggle for uniformity.[35] While this influence is tangible and more than speculative, it is nevertheless difficult of evaluation. Moreover, it is almost indisputable that if it were constitutionally permissible a more complete measure of uniformity could be achieved through the rule in *Swift v. Tyson* unencumbered by the jurisdictional amount statute, than by a simple faith that the states will sometimes unite in drafting identical laws on a

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[30]Domicile of party plaintiff; (2) domicile of party defendant; (3) place where contract was entered into; (4) place of performance of contract; (5) forum stipulated by parties to contract; (6) forum intended by implication, but not expressly stipulated by parties; (7) forum provided by statute; (8) place where tort was committed (sometimes a party to a contract may proceed with action *ex delicto* instead of action *ex contractu* on a matter originating in contract); (8) situs of the *rem.*

[31]Outstanding precedent can be applied in forty-eight different ways.

[32]REV. STAT. §§ 563, 629 (1875), 28 U. S. C. § 41 (1937).

[33]Powell, *supra* note 3, at 863.

[34]Davis v. Mills, 99 Fed. 39 (C. C. Conn. 1900).

[35]Powell, *supra* note 3, at 863.

broad subject like negligence and then unite in identical judicial construction of such laws.

However, a discussion of the various extra-legal machinery for promoting uniformity between state laws is a subject within itself and does not properly belong here. At any rate, uniformity in framework, which, along with a program of consistency in philosophy of law, constitutes a real need, can now be achieved only extra-legally and against the resistance of those who feel they are invested with inalienable rights in inharmony and inconsistency. And, of course, we will always find it difficult to explain to people not accustomed to a federal type of government, composed of forty-eight sovereign states, why it is that a man is bound by one law when he sues another in a state court, and by an entirely different law on the same question when he sues him in the courts of another state.

Federal Rule for Standard of Conduct

Probably the high point reached by the spawning of *Swift v. Tyson* was in negligence cases, such as *Baltimore & Ohio v. Goodman*.[36] Even so inveterate a dissenter from extension of the doctrine as Mr. Justice Holmes[37] was struck with the idealistic precision of the doctrine of uniformity in standard of conduct. In this, however, he was probably more legally consistent than appears at first thought.

It is not that as far as the logic of law is concerned there would be any recondite sin in one universal standard of conduct. It is that fundamentally a too-exacting regimentation or mechanization of standard of conduct in anything violates the natural law upon which our Declaration of Independence was founded. And more

[36]275 U. S. 66 (1927). Note the following language used by Mr. Justice Holmes at page 168 of 72 L. ed.: "But we are dealing with a standard of conduct, *and when the standard is clear* it should be laid down once for all by the courts." (italics ours). Accord: Pokora v. Wabash R. R., 292 U. S. 98, 102-103 (1934). However, the attitude in this case represents a departure from the absoluteness of the particular rule of standard of conduct suggested in Baltimore & Ohio v. Goodman.

[37]Dissenting opinions in Kuhn v. Fairmont Coal Co., 215 U. S. 349 (1910); Black & W. Taxicab & Transfer Co. v. Brown & Y. Taxicab & Transfer Co., 276 U. S. 518 (1928). In Kuhn v. Fairmont Coal Co., at page 370 of 215 U. S., Justice Holmes said: "This is a question of title to real estate. It does not matter in what form of action it arises, the decision must be the same in an action of tort that it would be in a writ of right. The title to real estate in general depends upon the statutes and decisions of the state within which it lies. I think it is a thing to be regretted if, while in the great mass of cases the state courts finally determine who is the owner of land, how much he owns, and what he conveys by his deed, the courts of the United States, when by accident and exception the same question comes before them, do not follow what, for all ordinary purposes, is the law."

particularly, in questions of due care it overrides our most elementary heritage in state rights. Since Justice Holmes would not extend *Swift v. Tyson* beyond the law merchant into the allied field of contracts,[38] it is difficult at first to see any proximate reason for extending it into the field of torts. In his desire for such extension he was as much for amending the Constitution by outright judicial fiat as was Justice Story in *Swift v. Tyson.*

As a matter of consistency in logic, the doctrine in *Swift v. Tyson* might either have been riveted tightly to the law merchant, or it might have been set up as a permanent substantive basis for complete uniformity in our jurisprudence.[39]

But there are further considerations which go to the very core of Holmes' identification here with the humane viewpoint, and its expression in interpretative evolution of the Constitution. There has always been a certain amount of natural animal law in our commercial law. And the inharmonious laws of forty-eight sovereign states only increases such resources available to the crafty. At the same time we have frowned upon the idea of the rule of tooth and fang influencing our law of torts. *A fortiori* we have promulgated constitutional guarantees of the very caprice in commercial law, both in the letter and in the spirit of the Constitution. But only by what seems to the hidebound conservative as the most strained interpretation of the Constitution have we read a modicum of such constitutional guarantees into the field of tort law. Fear of a theory of tort law being carried over into commercial law is always a reckoning factor. Holmes' unimpeachable logic in dissenting from an extension of the doctrine in *Swift v. Tyson* then becomes the very foundation for the strictly illogical but nonetheless salutary extension of the doctrine for the purpose of more humane considerations.

Then there is, however, a challenge by a variant sociological factor. Standard of conduct comprehends too much of intricate relevancy, if not of abstract ethics, for any degree of oneness. Even in the Golden Rule it is generalized in terms of human conscience. At the best, legislators can codify only the framework of the law defining it. Development or application within the framework is up to the courts. While a single court could uniformize, it would have to avoid crystalization and consequent destruction of the flexibility so inexorably a prime requisite in the administration of justice. People are contentious and intolerant in their multitudinous abstractions on code of conduct. But under

[38] *Ibid.*

[39] The utility of Swift v. Tyson in the field of law merchant is discussed *infra.*

judicial tolerance they keep it alive and inconstant. So most people can be right on such questions in spite of their extremely antipodal views.

The inconstancy of the law makes diversified application very desirable. Spencer's theory was that social statics result from a categorical domination by a single ideal. The saying that to treat people alike you must treat them differently may in the unpredictable distant future become axiomatic in the administration of justice. So if to the law's own inconstancy we add adjustments for ethnic, psychological, religious and economic differences, the result will be a standard of conduct headed toward justice tempered with mercy.

Standard of conduct is so broad within any field that it is difficult to say where simple propriety should end and law begin. Or it may be just as difficult to enumerate what is included within propriety. What may be propriety at one time and place may be law at another. What may be law at one time and place may be law out-of-age and out-of-place at another. The pattern of human behaviour of tomorrow cannot be so infallibly prefigured as to admit of goverance by linguistically precise law. The absolutism of precedent will have to give way to practical application of sociological ethics. The most impeccable administrator of justice would therefore live in the world of men, not in the realm of words. So on purely sociological grounds standard of conduct is too much accountable to human diversities and thus incapable of categorical expression to be formulated by a court circumscribed by a written constitution.

Swift v. Tyson and the Law Merchant

When Mr. Justice Holmes said that he would "leave *Swift v. Tyson* undisturbed" and "would not allow it to spread the assumed dominion into new fields,"[40] there was an imperative need for a central uniformizing authority in the law merchant. The need of commerce was for a flexibility in negotiable instruments that would enable them to pass state lines with as many as possible of the characteristics of money. It was not until 1895 that the states attempted to codify the law of negotiable instruments into a uniform act.[41] Nevertheless it was adopted with a range of variation

[40]Kuhn v. Fairmont Coal Co., 215 U. S. 349, 372 (1910); Black & W. Taxicab & Transfer Co. v. Brown & Y. Taxicab & Transfer Co., 276 U. S. 518, 535 (1928).

[41]California codified the law of negotiable instruments in 1872; but the first suggestion of a general codification of a uniform law was made in 1895. The first draft was submitted to the states in 1897, and it was adopted by four states in that year. The last state to adopt the Act was Georgia, in

in text.[42] And then even identical phrases and clauses of the parent act have been made inconsistent by the varying, almost irreconcilable, state interpretation.[43]

1924. The famous Ames-Brewster controversy in 1896, wherein Professor James Barr Ames, Dean of the Harvard Law School, criticised the Act, and Judge Lyman D. Brewster, President of the National Conference on Uniform State Laws, defended it, ironed out many of the difficulties. This debate is familiar to every student of the Act.

[42]Thirty-five states and the District of Columbia have adopted the Act with no less than two hundred distinct and material variations in the text. These variations range from the use of simple synonyms to the use of almost antithetical words, phrases, clauses and paragraphs. Minute examples of this would serve no useful purpose here. However, the following outstanding examples may be noted:

Sub-section 2 of Section 1 of the Uniform Act is as follows: "Must contain an unconditional promise or order to pay a sum certain in money." Georgia, however, has adopted this portion of the Act in this way: "Must contain an unconditional promise or order to pay a sum certain in money, provided that a promissory note may be made payable in cotton or other articles of value." (For an enlightening discussion of this section, see Culp, *Negotiability of Promissory Notes Payable in Specifics* (1937) 9 MISS. L. J. 277).

To Section 2 of the Act, North Carolina has added: "Nothing in this chapter shall authorize the enforcement of an authorization to confess judgment or a waiver of homestead and personal property exemptions or a provision to pay counsel fees for collection incorporated in any of the instruments mentioned in this chapter; but the mention of such provisions in such instruments shall not affect the other terms of such instruments or the negotiability thereof."

For the following sentence in Section 16 of the Act: "But where the instrument is in the hands of a holder in due course, a valid delivery thereof by all parties prior to him so as to make them liable to him is conclusively presumed," South Dakota substitutes: "An indorsee of a negotiable instrument in due course, acquires an absolute title thereto, so that it is valid in his hands, notwithstanding any defect in the title of the person from whom he acquired it."

In 1899 Wisconsin maligned somewhat the decision on the pre-existing debt proposition contained in Swift v. Tyson. It was held in Swift v. Tyson that a *bona fide* endorsee of a negotiable instrument for a pre-existing debt takes the instrument for value. That is the text of Section 25 of the Act. However, the Wisconsin legislature added the following to Section 25: "But the indorsement or delivery of negotiable paper as collateral security for a pre-existing debt, without other consideration, and not in pursuance of an agreement at the time of delivery, by the maker, does not constitute value."

Illinois has modified Section 57 of the Act by a provision that the defenses of fraud, circumvention and gaming are excepted.

New Hampshire makes more definite Section 71 of the Act by providing that demand be made on a demand promissory note within sixty days.

Thirteen states, Alaska, Hawaii and the Phillipines appear to have adopted the Uniform Act *in toto*, word for word.

[43]FOR EXAMPLE: A promissory note is non-negotiable if it provides that whenever the payee deems it insecure he may, even before maturity, treat it as due. Murrell v. Exchange Bank, 168 Ark. 645, 271 S. W. 21 (1925); Holliday State Bank v. Hoffman, 85 Kan. 71, 116 Pac. 239 (1911); Western Farquhar Machine Co. v. Burnett, 82 Ore. 174, 161 Pac. 384 (1916). *Contra*: First National Bank v. McCartan, 206 Iowa 1036, 220 N. W. 364 (1928); First State Bank v. Barton, 129 Okla. 167, 263 Pac. 142 (1928); Puget Sound State Bank v. Washington Paving Co., 94 Wash. 504, 162 Pac. 870 (1917).

Under Section 60 of the N. I. L. it has been held that a holder in due course can recover against the maker of a promissory note made to the order of a

Federal jurisdiction was assumed in *Swift v. Tyson* on the ground of diversity of citizenship.[44] So far as is known, federal courts have never taken jurisdictional cognizance of the law merchant in interstate commerce.[45] There is nothing in Justice Story's opinion, except the simple geographical illustration, to indicate that he decided the question on other than accepted principles of law merchant as developed where the federalization of interstate commerce was unknown. And yet negotiable instruments are an absolute economic incidence of interstate commerce. State inconsistency in negotiable instruments law and interpretation imposes upon interstate commerce a burden that is more purely legistically arbitrary than economic. The leavening factor is the slight extent of the burden; in principle the burden actually exists, with potentialities.

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foreign corporation which had not complied with statutory provisions governing right to do business in the state. Moody v. Morris-Roberts Co., 38 Idaho 414, 226 Pac. 278 (1924); Despres, Bridges & Noel v. Hough Drug Co., 123 Miss. 598, 86 So. 359 (1920); Halsey v. Jewett Co., 190 N. Y. 231, 83 N. E. 25 (1907). *Contra*: Dean v. Caldwell, 141 Ark. 38, 216 S. W. 31 (1919). It is interesting to note, however, that the United States Circuit Court of Appeals has refused to follow the Arkansas rule on this point even in a case arising in Arkansas. Ockenfels v. Boyd, 297 Fed. 614 (C. C. A. 8th, 1924).

Parol evidence is not admissible to prove that a party to an instrument intended to be an endorser. Lumbermen's National Bank v. Campbell, 61 Ore. 123, 121 Pac. 427 (1912). *Contra*: Gillam v. Walker, 189 N. C. 189, 126 S. E. 424 (1925).

It has been held that a sealed instrument is not subject to the defense of want of consideration, since a seal imports consideration. Kennedy v. Collins, 30 Del. 426, 108 Atl. 48 (1919). *Contra*: Citizens' National Bank v. Custis, 153 Md. 235, 128 Atl. 261 (1927).

Fraud allowed as a defense. Munsey Trust Co. v. Minker, 296 Fed. 991 (App. D. C. 1924); Pocatello Sec. Trust Co. v. Henry, 35 Idaho 321, 206 Pac. 175 (1922); Vilas State Bank v. Peterson, 114 Kan. 164, 216 Pac. 1085 (1923); Horowitz v. Kuehl, 117 Wash. 16, 200 Pac. 570 (1921). *Contra*: Howley Lumber Co. v. Nordling, 168 Minn. 70, 209 N. W. 484 (1926); Peoples' Nat. Bank v. Southern States Finance Co., 192 N. C. 69, 133 S. E. 415 (1926); Bank of Jordan Valley v. Duncan, 105 Ore. 105, 209 Pac. 149 (1922).

These few examples have been selected at random, with no thought of finding particular examples illustrating a dependent relation between negotiable instruments law and interstate commerce. Neither would any useful purpose be served by listing an exhaustive series of examples of variant judicial interpretations of negotiable instruments law.

[44]In this respect, of course, the assumption of jurisdiction is unquestioned. Young v. Bryan, 6 Wheat. 146 (U. S. 1821); Goldsmith v. Holmes, 36 Fed. 484 (C. C. Ore. 1888), *aff'd.* 147 U. S. 150 (1893); Kolze v. Hoadley, 200 U. S. 76 (1906). For the rule that jurisdiction by virtue of diversity of citizenship is the sole reason for not being bound by decisions of state courts, see L. & G. W. Steam Co. v. Phenix Ins. Co., 129 U. S. 397, 443 (1889).

[45]In Dubuque, *etc.*, R. R. v. Richmond, 19 Wall. 584 (U. S. 1874), it was held that the federal power to regulate commerce is not to be exercised in such a manner as to interfere with private contracts not purposely designed to impede interstate commerce. This is the nearest approach to an adjudication on negotiable instruments in interstate commerce. Furthermore, in Hooper v. California, 155 U. S. 648, 655 (1895) the Supreme Court of the United States said: "If the power to regulate interstate commerce applied

Under the sweeping implications of *Erie v. Tompkins,* comparable to those of *Swift v. Tyson* of a hundred years ago, dominion over the law merchant in diversity of citizenship cases has been released back to the states. As Cicero feared, the law can now be one thing at Rome and another at Athens; as Justice Story feared, it can be one thing at Boston and another at New York. In practice federal courts can no longer exert any influence for the sake of consistency. One day state courts will apply the law of New York, the next that of Massachusetts or California, in suits between the same parties, whether they are engaged in intrastate or interstate commerce.[46] Application of a particular state law on the question therefore depends to an appreciable extent upon the indirection of interstate commerce. Analogous to the accumulation of precedent under *Swift v. Tyson,* by judicial interpretation interstate commerce has been extended in the direction of its own enhancement,[47] for the purpose of unifying commercial transactions into a free-flowing national pattern.

One should naturally hesitate to read into the language of Justice Holmes' dissenting opinions any thought of the law merchant in interstate commerce. Notwithstanding our reticence, the unexpanded dissent now becomes authoritative, and theoretically embryonic of a design for remoulding a field of law thrown back into controversial inconsistency by *Erie v. Tompkins.* The impli-

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to all the incidents to which said commerce might give rise and to all contracts which might be made in the course of its transaction, that power would embrace the entire sphere of mercantile activity in any way connected with trade between the States, and would exclude State control over many contracts purely domestic in their nature." See Nathan v. Louisiana, 8 How. 73 (U. S. 1850), in which it was held that dealing in bills of exchange does not constitute interstate commerce. See also Culp, *Negotiability of Promissory Notes Payable in Specifics* (1937) 9 MISS. L. J. 277.

[46]Tatum v. Commercial Bank, *etc.*, Co., 193 Ala. 120, 69 So. 508 (1915) (governed by law of place where contract made); Warneke v. Preissner, 103 Conn. 503, 131 Atl. 25 (1925) (sometimes governed by situs of land mortgaged); Mayer v. Roche, 77 N. J. L. 681, 75 Atl. 235 (1909) (governed by intent of parties); Coral Gables v. Christopher, 189 Atl. 147 (Vt. 1937) (law of forum governs only as to adjective matters); Jefferies v. Kanawha Fuel Co., 182 Wis. 203, 196 N. W. 238 (1923) (governed by law of place of payment).

[47]Gibbons v. Ogden, 9 Wheat. 1 (U. S. 1824); Cooley v. Board of Wardens of Philadelphia, 12 How. 299 (U. S. 1851); Munn v. Illinois, 94 U. S. 112 (1876); Pensacola Tel. Co. v. Western Union Tel. Co., 96 U. S. 1 (1878); Mobile County v. Kimball, 102 U. S. 691 (1881); Monongahela Nav. Co. v. United States, 148 U. S. 312 (1893); Western Union Tel. Co. v. James, 162 U. S. 650 (1896); United States v. Joint Traffic Association, 171 U. S. 505 (1898); Addyston Pipe, *etc.*, Co. v. United States, 175 U. S. 211 (1899); Interstate Commerce Commission v. Ill. Cent. R. R., 215 U. S. 452 (1910); International Textbook Co. v. Pigg, 217 U. S. 91 (1910); Rossi v. Pennsylvania, 238 U. S. 62 (1915); Caminetti v. United States, 242 U. S. 470 (1917); Pullman Co. v. Linke, 203 Fed. 1017 (D. C. S. D. Ohio 1913); Glaser v. United States, 224 Fed. 84 (C. C. A. 7th, 1915).

cation is probably alarming in some quarters.[48] The federalization of another incident to commerce would find its most bitter foes among those whose philosopohy of law is based on individual demands, not group expediency. And yet our every political, economic and constitutional crisis has been met by federalization. When individual states become too petty over *laissez-faire*, commerce instinctively abandons its own idea of self-sufficiency for more domestic uniformity.

It is not that there is any crisis over variations in the law merchant. The Uniform Negotiable Instruments Act has functioned to provide a greater degree of uniformity than ever could have been attained by state judicial legislation. It is that while we are at the threshold of curtailment of federal judicial legislation in many fields, including the law merchant, our ever-increasing respect for Justice Holmes' wisdom suggests a conservative but salutary commercial expedient—the very antithesis of that which some may have once feared for his philosophy of law.

The drawing, acceptance, negotiation and discharge of a negotiable instrument involves *per se* a course of human conduct apart from that involved in the transaction out of which grew the necessity of the instrument. This conduct is more susceptible of reduction to an approximate standard than is conduct in the exercise of care or conduct deteriorated to negligence. The drawing or negotiation of an instrument usually consummates a course of conduct through which the parties have purposely arrived at a meeting of minds. Care and negligence as objects of human conduct are most often involved in the unpredictable, surprising, acts of others.

On account of the quality and character of money, conduct surrounding its use has been refined to a standard absolute within

[48]In discussing Erie v. Tompkins with the Bar generally, I have found some who believe, and unhesitatingly say, that the decision in the case is a frank suggestion by the Court that federal encroachment upon states' rights has already gone too far. Although the thought may have its origin in purely partisan considerations, it is not for that reason to be disregarded. *Bona fide* diverse theories of politico-jurisprudence still come from the hazy dividing line between the tenets of our two major political parties. On the contrary, the Court might be commended for its cognizance of this conservative trend in popular thought, just as it might be commended for cognizance of any major trend in thought. No court should crusade for change, salutary as the ideal may be. It can only recognize that the people desire that legal interpretation and construction be kept abreast of the unmistakable trend of the times. However, so often partisan politics are just irresponsible enough to condemn government today for upholding something for which they would commend it tomorrow, or *vice versa*. Both in politics and in law the majority view is sound today and unsound tomorrow. From the partisan standpoint, it all depends upon the point of view, rather than upon the accuracy of the sensing of popular movements.

itself and circumscribed by an irreducible minimum of restriction. In the substitution of bills and notes for money, conduct can be categorized relatively to the same approximate minimum. That is the purpose behind the adoption of a uniform negotiable instruments act. It is justification for mandatory uniform interpretation of identical textual provisions. A measure of success in the latter has been achieved in spite of state administration and interpretation. But in spite of the fact that the people would never consent to a surrender of the law of money by the federal government to the states, it is at least doubtful whether the states would ever consciously and purposely surrender the statutory law of negotiable instruments to the federal government. So Mr. Justice Holmes' acceptance of *Swift v. Tyson,* together with all the cases involving the law merchant and general commercial law decided thereunder, fulfill the demand.

CRIMINAL BREACH OF TRUST AND CORPORATE MISMANAGEMENT—PART II.*

Orvill C. Snyder

IV. Application of the Rules of Fraudulent Conversion to Persistent Forms of Mismanagement

1. Loans of Corporate Funds

With regard to civil liability,[103] "directors and other corporate officers are liable where they have either wilfully or negligently made bad loans or investments, resulting in loss to the corporation, provided the loan or investment was not a mere mistake in judgment."[104] "But in determining the wisdom of a loan or investment it must always be remembered that the conditions at the time it was made are the important ones and that the deal is not to be viewed merely from its after effects."[105] In the absence of express statutory prohibition, directors and officers may become borrowers from the corporation; but "if corporate officers become borrowers from the corporation, their transactions for their own benefit are closely scrutinized."[106] The mere fact that the transaction was with a director or officer,[107] or the wife of a director or officer,[108] or a corporation in which the director or officer was stockholder, director, or officer,[109] is enough to raise the question of fairness. If upon close scrutiny such a transaction is fair, it will be permitted to stand, according to the weight of authority.[110] The same rule applies if a stockholder in one corporation procures that corporation's entering into a "deal" with another corporation in which he is interested;[111] and, of course, a less number than all of the stockholders cannot authorize unfair "deals".[112] Unfair "deals" are invalid as to strangers who knowingly join with officers in making them, just as much as they are as to those persons who

*This is the second installment of this article which was begun in the December, 1938 issue of the Journal. The last installment will appear in the April, 1939 issue.

[103]Secondary authorities will be used to indicate the general principles of civil liability as a background for discussion of primary authorities on criminal liability.

[104]3 Fletcher, *op. cit. supra* note 12, c. 11, § 1019.

[105]*Id.* § 1041.

[106]*Id.* § 955.

[107]*Id.* §§ 913, 918, 921, 937, 939, 941, 943.

[108]*Id.* § 946.

[109]*Id.* §§ 944, 961, 967.

[110]*Id.* § 931.

[111]*Id.* §§ 945, 963; 13 *id.* c. 58, § 5832.

[112]*Id.* §§ 979, 982; 13 *id.* c. 58, §§ 5795, 5810, 5811, 5812.

sustain some fiduciary relation to the corporation.[113] However, an officer is not liable where he acts in "good faith" under the directions of superiors.[114] But, whatever be the controversies about directors' and officers' duties of diligence and care, from *Hun v. Cary*[115] down to *Spering's Appeal*,[116] all authorities insist upon "good faith".[117] So, in the end, we always come to a definition of good faith, or of fraud, as the ultimate criterion by which to divide mere mistakes in judgment from breach of duty and mere maladministration from criminal misappropriation.[118]

Embezzlement—or fraudulent conversion as embezzlement, misapplication, or abstraction—can be committed by means of a loan, whether made in the usual manner of making loans or by honoring overdrafts, and whether made in a simple direct transaction or in a roundabout series of transactions.[119] In prosecutions for fraudulent loans, practically every variety of defense contention has been unavailingly made. It has been urged that there was no intent permanently to deprive the corporation of anything, but only an intent to use temporarily, and even that restitution actually was made.[120] Objection has been made to the introduc-

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[113]See cases cited *supra* note 27.

[114]3 FLETCHER, *op. cit. supra* note 12, c. 11, § 940; Rubert v. American Surety Co., 26 N. M. 365, 192 Pac. 487 (1920).

[115]82 N. Y. 65 (1880) (the high duty case).

[116]71 Pa. 11 (1872) (the low duty case).

[117]BALLANTINE, CORPORATIONS (1927) 360-367; 3 FLETCHER, *op. cit. supra* note 12, c. 11, §§ 1084, 1085, 1086.

[118]See Reeves v. State, 95 Ala. 31, 44, 11 So. 158 (1891).

[119]Evans v. United States, 153 U. S. 584 (1893); Coffin v. United States, 162 U. S. 664 (1895); Olmstead v. United States, 29 F. (2d) 239 (C. C. A. 9th, 1928), *cert. denied* 279 U. S. 849 (1929); Robinson v. United States, 30 F. (2d) 25 (C. C. A. 6th, 1929); Savitt v. United States, 59 F. (2d) 541 (C. C. A. 3rd, 1932); Morrissey v. United States, 67 F. (2d) 267 (C. C. A. 9th, 1933), *rehearing denied*, 70 F. (2d) 729 (C. C. A. 9th, 1934), *cert. denied*, 293 U. S. 566 (1934); Hargreaves v. United States, 75 F. (2d) 68 (C. C. A. 9th, 1935); House v. United States, 78 F. (2d) 296 (C. C. A. 6th, 1935), *cert. denied*, 296 U. S. 608 (1935); United States v. Fish, 24 Fed. 585 (C. C. S. D. N. Y. 1885); United States v. Youtsey, 91 Fed. 864 (C. C. D. Ky. 1898); United States v. Breese, 131 Fed. 915 (W. D. N. C. 1904); United States v. Mulloney, 8 Fed. Supp. 674 (D. C. Mass. 1934); Reeves v. State, 95 Ala. 31, 11 So. 158 (1891); People v. Talbot, 22 P. (2d) 587 (Cal. App. 1933), 220 Cal. 3, 28 P. (2d) 1057 (1934); People v. Kolowich, 262 Mich. 137, 247 N. W. 133 (1933); State v. Kortgaard, 62 Minn. 7, 64 N. W. 51 (1895); State v. Holmes, 65 Minn. 230, 68 N. W. 11 (1896); Young v. State, 44 Ohio App. 1, 184 N. E. 24 (1932); State v. Hattrem, 140 Ore. 371, 13 P. (2d) 618 (1932); Commonwealth v. Wilcox, 316 Pa. 129, 173 Atl. 653 (1934); State v. Larsen, 123 Wash. 21, 211 Pac. 123 (1923); State v. Linden, 171 Wash. 92, 17 P. (2d) 635 (1935); Wille v. State, 207 Wis. 163, 240 N. W. 823 (1932).

Some of the cases involve other than banking corporations. There are other cases, not cited, in which the loan came under some express statutory prohibition. The cases cited are instances of abuse of discretion.

[120]House v. United States, People v. Talbot, State v. Larsen, State v. Linden, Wille v. State, all *supra* note 119. And see Russell v. State, 112 Ark.

tion of evidence of surrounding circumstances and of other transactions.[121] It has been contended that the defendant did no act of paying out funds but merely made an entry and others did the paying out.[122] Exoneration has been sought on the ground that the defendant personally received no benefit,[123] on the ground that he occupied no fiduciary relation to the corporation,[124] and on the ground that he merely stood by while other officers did the converting.[125] It has been asserted that the defendant did not have the requisite 'possession' by being in general charge of the 'property', or in charge concurrently with other officers.[126] Points have been argued that the defendant could have had no fraudulent intent because his own funds were invested in the corporation;[127] that he was purchasing stock of the corporation, or of another company which held stock of the corporation, for the purpose of

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282, 166 S. W. 540 (1914); Spalding v. People, 172 Ill. 40, 49 N. E. 993 (1898); Fowler v. Wallace, 131 Ind. 347, 31 N. E 63 (1891); State v. Schumacher, 162 Iowa 231, 143 N. W. 1110 (1913); State v. Pratt, 114 Kan. 550, 220 Pac. 515 (1923); Morrow v. Commonwealth, 157 Ky. 486, 163 S. W. 452 (1914); People v. Butts, 128 Mich. 208, 87 N. W. 224 (1901); State v. Lentz, 184 Mo. 223, 83 S. W. 970 (1904); People v. Shears, 158 App. Div. 577, 143 N. Y. S. 861, *aff'd.* 209 N. Y. 610, 163 N. E. 1129 (1913); State v. Baxter, 89 Ohio St. 269, 104 N. E. 331 (1914).

[121]Reeves v. State, People v. Talbot, People v. Kolowich, State v. Kortgaard, Young v. State, State v. Linden, all *supra* note 119. And see People v. Ward, 134 Cal. 301, 66 Pac. 373 (1901); Phenneger v. People, 85 Colo. 442, 276 Pac. 983 (1929); People v. Duzan, 272 Ill. 478, 112 N. E. 315 (1916); State v. Lake, 99 Mont. 128, 43 P. (2d) 627 (1935); State v. Hattrem, 140 Ore. 371, 13 P. (2d) 618 (1932); State v. Comer, 176 Wash. 257, 28 P. (2d) 1027 (1934).

[122]United States v. Fish, 24 Fed. 585 (C. C. S. D. N. Y. 1885). And see *Ex parte* Hedley, 31 Cal. 109 (1866); State v. Meininger, 306 Mo. 675, 268 S. W. 71 (1925); Bartley v. State, 55 Neb. 294, 75 N. W. 832 (1898); People v. Canadian Fur Trappers Corp., 248 N. Y. 159, 161 N. E. 455 (1928); Hitchcock v. State, 47 Ohio App. 90, 190 N. E. 773 (1933); State v. Ross, 55 Ore. 450, 104 Pac. 596, 106 Pac. 1022 (1911).

[123]Coffin v. United States, 162 U. S. 664 (1895). And see State v. Meininger, 306 Mo. 675, 268 S. W. 71 (1925); State v. Ross, 55 Ore. 450, 104 Pac. 596, 106 Pac. 1022 (1911).

[124]Coffin v. United States, Robinson v. United States, Savitt v. United States, State v. Hattrem, all *supra* note 119. Note the aiders and abettors in these cases who were neither stockholders, officers, directors, or employees. In Evans v. United States, 153 U. S. 584 (1893), the aider and abettor was a director, who himself had no possession. In Olmstead v. United States, 29 F. (2d) 239 (C. C. A. 9th, 1928), *cert. denied,* 279 U. S. 849 (1929), the aider and abettor was a stockholder and customer.

[125]State v. Linden, 171 Wash. 92, 17 P. (2d) 635 (1935). See note 50, *supra.*

[126]Reeves v. State, 95 Ala. 31, 11 So. 158 (1891). And see People v. Gordon, 206 Cal. 29, 273 Pac. 568 (1928); State v. Johnson, 109 Kan. 239, 199 Pac. 104 (1921); People v. Butts, 128 Mich. 208, 87 N. W. 224 (1901); Higbee v. State, 74 Neb. 331, 104 N. W. 748 (1905); Bartley v. State, 53 Neb. 310, 73 N. W. 744 (1897); and Smith v. State, 53 Tex. Cr. 117, 109 S. W. 118 (1908).

[127]People v. Talbot, 22 P. (2d) 587 (Cal. App. 1933), 220 Cal. 3, 28 P. (2d) 1057 (1934).

sustaining the market position of the corporation's stock;[128] that the defendant's management had previously been brilliant and had made profits for the corporation;[129] that the defendant was a man of large means, able to respond and hence could not defraud;[130] and that the whole trouble was economic conditions which had embarrassed the defendant so that he could not, and without fault on his part, meet his obligations.[131] Want of secrecy also has been unsuccessfully urged.[132] The opinions emphasize that prosecution is not for errors of judgment.[133] The inquiry goes forward under the head of intent to defraud; and we must now look to the decisive factors in determining the existence of this element.[134]

Whether or not the loan is made with intent to defraud depends upon whether or not it is made with unwarranted risk of loss to the corporation.[135] Three lines of evidence appear to be of decisive import: (1) While secrecy is not necessary for fraudulent conversion to occur, its presence, as evidenced by false entries at the time, by later concealment, by extending credit on "kited checks", or by making loans to "straw men", is highly inculpatory, and has even been said to be conclusive evidence of intent to defraud.[136] Consequently, if the defendant deliberately tries to avoid liability by making the transaction an involved one, he thereby creates evidence which will tell very strongly against him. A complex transaction, of course, makes the evidence hard to get and

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[128]House v. United States, Morrissey v. United States, People v. Talbot, all *supra* note 119. There may be a duty on the part of directors to sustain the market for the corporation's own shares. See BERLE AND MEANS, *op. cit. supra* note 23, at 174-176. Since about all the stockholder has left is the chance to realize on the market, this expectation may well be thought to be the substance of his 'property'. See BERLE AND MEANS, *op. cit. supra* note 23, bk. II, c. 8. If the directors or officers are "sustaining the market", the question is: For the benefit of those who hold beneficial interests in the corporation or at corporate risk for the directors' and officers' own benefit?

[129]State v. Hattrem, 140 Ore. 371, 13 P. (2d) 618 (1932).

[130]People v. Talbot, 22 P. (2d) 587 (Cal. App. 1933), 220 Cal. 3, 28 P. (2d) 1057 (1934); and see State v. MacCullough, 115 Conn. 306, 161 Atl. 512 (1932); Masters v. United States, 42 App. D. C. 350 (1914); Doxen v. State, 151 Md. 118, 134 Atl. 166 (1926); State v. Lake, 99 Mont. 128, 43 P. (2d) 627 (1935).

[131]State v. Kortgaard, 62 Minn. 7, 64 N. W. 51 (1895).

[132]Reeves v. State, People v. Talbot, State v. Linden, all *supra* note 119.

[133]See especially Robinson v. United States, Morrissey v. United States, United States v. Breese, United States v. Mulloney, all *supra* note 119.

[134]See note 10, *supra*.

[135]*Ibid.*

[136]Olmstead v. United States, Robinson v. United States, Savitt v. United States, Morrissey v. United States, Hargreaves v. United States, United States v. Fish, United States v. Youtsey, State v. Holmes, Young v. State, Commonwealth v. Wilcox, all *supra* note 119. Robinson v. United States, *supra*, says that the inference of intent to defraud cannot be avoided. What is not known cannot be said to be open. People v. Fewkes, 214 Cal. 142, 4 P. (2d) 538 (1931); State v. Taylor, 140 Kan. 663, 38 P. (2d) 680 (1934).

is highly confusing to the jury; but, since accountants may testify as to their findings,[137] this latter difficulty may be overcome by a capable prosecutor. (2) The second line of inquiry is the financial responsibility of the borrower, whether he be the defendant or another, and the value of securities given, together with the value of properties covered by these securities.[138] It seems that if the evidence clearly establishes the extraordinary and unreasonable risk and recklessness of the loan, it is sufficient in itself to sustain the charge.[139] However, since the loan must be judged as of the time when it is made and not by "hindsight", this evidence frequently is not decisive. If secrecy also exists, the evidence is very strong; for, if secrecy exists, it is hard not to believe that the defendant in some way favored his own interests when in conflict with the interests of the corporation.[140] (3) The third line of evidence is gain to the defendant. Gain to the defendant is not necessary but is usually present;[141] and, when present, it apparently is decisive of intent to defraud. Gain to the defendant is shown when he receives the funds loaned himself, either directly or through intermediaries who later turn the proceeds over to him;[142] when the funds go to a firm in which the defendant is a partner,[143] or to a corporation in which he is a stockholder[144] (especially a large stock-

[137]LeMaster v. People, 54 Colo. 416, 131 Pac. 269 (1913); People v. Wulff, 313 Ill. 286, 145 N. E. 108 (1924); People v. Preble, 316 Ill. 233, 147 N. E. 124 (1925).

[138]Evans v. United States, Coffin v. United States, Olmstead v. United States, Robinson v. United States, Morrissey v. United States, United States v. Youtsey, United States v. Breese, United States v. Mulloney, Reeves v. State, People v. Talbot, People v. Kolowich, State v. Hattrem, Commonwealth v. Wilcox, Wille v. State, all *supra* note 119. See also People v. Stevens, 358 Ill. 391, 193 N. E. 154 (1934).

[139]Morrissey v. United States, 67 F. (2d) 267 (C. C. A. 9th, 1933), *rehearing denied*, 70 F. (2d) 729 (C. C. A. 9th, 1934), *cert. denied*, 293 U. S. 566 (1934); and see Lear v. United States, 147 Fed. 349, 359 (C. C. A. 3rd, 1906); Walsh v. United States, 174 Fed. 615 (C. C. A. 7th, 1909). Robinson v. United States, United States v. Mulloney, both *supra* note 119, emphasize the point of incurring unwarranted risk; the loan may actually be repaid sometime.

[140]This seems to be the essence of "bad faith". See note 10, *supra*.

[141]It was in the cases cited, *supra*, note 119.

[142]See especially Hargreaves v. United States, United States v. Youtsey, United States v. Breese, Reeves v. State, People v. Talbot, People v. Kolowich, State v. Holmes, State v. Kortgaard, Young v. State, State v. Hattrem, Commonwealth v. Wilcox, all *supra* note 119.

[143]United States v. Fish, 24 Fed. 585 (C. C. S. D. N. Y. 1885).

[144]See especially Morrissey v. United States, United States v. Mulloney, People v. Talbot, State v. Kortgaard, State v. Linden, Wille v. State, all *supra* note 119. And see People v. Fleming, 17 P. (2d) 1042 (Cal. App. 1932), *rehearing denied*, 220 Cal. 601, 32 P. (2d) 593 (1934); State v. MacCullough, 115 Conn. 306, 161 Atl. 512 (1932); Kennedy v. State, 196 N. E. 316 (Sup. Ct. Ind. 1935); Commonwealth v. Moore, 166 Mass. 513, 44 N. E. 612 (1896); People v. Meadows, 199 N. Y. 1, 92 N. E. 128 (1896); People v. Shears, 159 App. Div. 577, 143 N. Y. S. 861 (1913), *aff'd*, 209 N. Y. 610, 163 N. E. 1129

holder); and when the funds are used by other persons for speculation in the profits of which, if there are any, the defendant will share.[145] Where the gain is to an aider and abettor rather than to the principal offender, the gain may be to a corporation in which the aider and abettor is interested.[146]

A loan fits the ancient formula of conversion; it can be analogized to a servant's withdrawing and going away with a chattel.[147] The necessary fiduciary relations and the requisite 'possession' are worked out through the directors and officers who control and manage the corporate 'property'. Others who take a part are connected with the acts of these directors and officers as aiders and abettors. If, at the time the loan is made,[148] the posture of affairs is such that inevitable loss or unreasonable risk of loss is incurred, and especially if accompanying this posture of affairs there is prospect of personal gain to the directors or officers making the loan (to which, of course, may be added secrecy, always remembering that what is not known is secret),[149] there is only one situation which can prevent the loan from being a fraudulent conversion of the funds applied to it.[150] This situation is that the loan in no way

(1913); State v. Thomas, 123 Wash. 299, 212 Pac. 253 (1923); Milbrath v. State, 138 Wis. 354, 120 N. W. 252 (1909); State *ex rel.* v. Gilbert, 213 Wis. 196, 251 N. W. 478 (1933).

[145]See especially Morrissey v. United States, House v. United States, People v. Talbot, all *supra* note 119.

[146]Coffin v. United States, 162 U. S. 664 (1895). Note that People v. Stevens, 358 Ill. 391, 193 N. E. 154 (1934), is distinctly against the weight of authority, on the defense contention that the defendant did not get the money but that some corporation did. It is enough if the defendant had an interest, especially a large interest, in the corporation. That is gain to him. See comment on People v. Stevens, *supra*, in (Jan., Feb. 1937) THE JOURNAL OF CRIMINOLOGY.

[147]See note 119, *supra*. Note, in Robinson v. United States, 30 F. (2d) 25 (C. C. A. 9th, 1933), the language, at 27, about indebtedness to bank being increased and the money paid out misapplied.

[148]See note 105, *supra*.

[149]People v. Fewkes, 214 Cal. 142, 4 P. (2d) 538 (1931); State v. Taylor, 140 Kan. 663, 38 P. (2d) 680 (1934). See also Walter v. State, 1 N. E. (2d) 127, 130 (Sup. Ct. Ind. 1936).

[150]See cases cited *supra* note 119 on what is converted. The opinion in Kingsbury v. State, 27 Ariz. 289, 232 Pac. 887 (1925), says that there was a conversion because the loan, being in excess of a certain percentage of the capital stock, was prohibited. But the prohibition seems to be bottomed upon hazard of loss and to amount to a legislative declaration that such a prohibited loan is dangerous. Otherwise, the statute would be unreasonable.

The finding of conversion, except where the loss is total or a precise part of the amount loaned, must rest upon the fact that the act jeopardized the total amount loaned. There is no difficulty in the fact that the precise amount charged is not proven, nor in that the jury does not fix the amount converted exactly at that which the evidence establishes. All that is necessary is that the proof establish the statutory minimum to make a felony or any value to make a misdemeanor. People v. Jasiecki, 301 Ill. 23, 133 N. E. 281 (1921);

affects corporate solvency so as to interfere with creditors' rights, and that all the stockholders assent.[151]

2. Excessive Salaries

Directors and officers who have authority to fix salaries are civilly liable for fixing and paying out, or causing to be paid out, salaries which are excessive, whether to themselves or to others.[152] The rule doubtless applies just as much to a salary paid to a person whose services are utterly unnecessary as to a salary excessive in amount paid to one entitled to something less. If the person receiving the salary has no power to fix or pay the salary, if he does nothing whatever to influence those who pay him the salary to do so, or if he does not assist them in getting the salary for themselves through him as a "dummy", he is not liable for any breach of trust of his own nor for aiding and abetting any one else in breaking his trust.[153] The principle of this liability embraces those who are in authority and those who are influential enough to "control" the person or persons formally in authority. The form in which the salary is paid—whether in money, goods, or stock—makes no difference;[154] nor does the fact that the salary questioned is an increase or an amount fixed originally.[155] Excessive compensation cannot be ratified by a majority of the stockholders.[156] While the amount of compensation is within the discretion of the directors and courts are loath to interfere,[157] the amount must have some reasonable relation to the value of services and the results accomplished.[158] Where those receiving the compensation are also directors, it seems that a closer scrutiny is practiced than in those instances in which the compensation goes to employees or officers who are not directors; " 'for directors cannot fix the value of their own services to the corporation' ".[159] Corporate assets may be dissipated through salaries paid to any one, but the real hazard lies in payments to the directors and officers in control and not in ex-

People v. Preble, 316 Ill. 233, 147 N. E. 124 (1925); Young v. State, 44 Ohio App. 1, 184 N. E. 24 (1932).

[151]See cases cited *supra* note 101.

[152]BALLANTINE, CORPORATIONS (1927) 409; 3 FLETCHER, *op. cit. supra* note 12, c. 11, § 1110; 5 *id.*, c. 16, §§ 2125, 2132, 2139, 2171. The rule extends to acts of the majority of stockholders as well.

[153]See McConnell v. Combination Mining & Milling Co., 30 Mont. 239, 76 Pac. 194 (1904), 31 Mont. 563, 79 Pac. 248 (1905). But note that the rule about aiders and abettors can be applied where the person receiving and the person paying act together. See cases cited *supra* note 20.

[154]5 FLETCHER, *op. cit. supra* note 12, c. 16, §§ 2137, 2143.

[155]*Id.* § 2138.

[156]*Id.* § 2139.

[157]*Id.* § 2133.

[158]*Id.* §§ 2125, 2133.

[159]*Id.* § 2133, quoting at p. 434 from Bennett v. Klipto Loose Leaf Co., 201 Iowa 236, 207 N. W. 228 (1926).

cessive compensation paid to subordinates or mere employees. "Added prosperity of a corporation does not justify an increase of compensation, as the officers perform their services to produce such results, and the value of services is not to be determined by rules of proportion so as to absorb all the profits of a company."[160] And "the fact that an officer owns a majority of the stock of a corporation does not authorize him to increase, or effect an increase of his compensation in disregard of the corporate regulations; neither does the fact that officers receiving big salaries are the principal stockholders bear at all on their legal right thereto. . ."[161] Limitations, similar to the foregoing, applicable to draining off revenues to themselves as directors and officers through excessive salaries seem just as appropriate with respect to their conduct when they quarter their relatives on a corporation which they control.

These principles are simply a recognition of the elementary judicial concept that the corporate 'property' does not belong to the directors and officers. However, courts have looked leniently upon big compensation for management;[162] and although courts always acknowledge the fiduciary relation, they have often been reluctant to interfere with the exercise of a discretion by which directors and officers transfer to their own pockets 'property' which, by every judicially recognized principle of corporation law, does not belong to them. Judicial reluctance to interfere with what is called discretionary activities of management creates a large uncontrolled area by means of which the very concept of the corporation, which the courts themselves have elaborated, is destroyed. That concept is that the corporate 'property' belongs beneficially to the stockholders and creditors. Directors and officers, by means of an uncontrolled discretion, can transfer corporate assets to themselves simply by selecting debatable expedients for the operation. By judicial refusal to set standards limiting such practices the corporate 'property' is commensurately made the 'property' of management rather than of the stockholders and creditors, and the fundamental corporate concept is destroyed by its creators.[163] The remedies of objecting stockholders easily prove to be illusory.[164] While we are accustomed to consider disregard of due process as being only a matter of taking one person's 'property' and transferring it to another in violation of well-established rules of 'property'

[160] *Id.* § 2138, at 445.
[161] *Id.* § 2138, at 444.
[162] *Id.* § 2138, at 445, n. 15, and § 2143.
[163] See Rogers v. Guaranty Trust Co., 288 U. S. 123 (1933).
[164] See Notes (1933) 21 CALIF. L. REV. 358, (1933) 42 YALE L. J. 419; and Comments (1933) U. OF CIN. L. REV. 412, (1933) 46 HARV. L. REV. 828, (1932) 81 U. OF PA. L. REV. 220, 635, (1933) 42 YALE L. J. 792.

law established by legislative act, courts, when they refuse to apply their own principles of close scrutiny and their own basic concept of corporate 'property' to the compensation of those in control of corporations, deny that same constitutional right. Their reluctance is at variance with every judicially announced principle for dealing with fiduciaries[165] and is a denial of the "property rights" legally recognized by the existence of the fiduciary relations which directors, officers, and those in "control" are judicially held to sustain. In general, the law as to salaries and other forms of compensation of corporate officers and directors cannot be said to have been worked out with that judicial fidelity which basic judicial conceptions of the corporation and of fiduciary relations necessitate.[166]

Corporate 'property' can as much be withdrawn and fraudulently converted in the guise of salaries as by any other means.[167] The chief point of inquiry is intent to defraud. Upon this point, evidence as to the value of services, secrecy, and the financial condition[168] of the corporation are admissible. If the amount paid is clearly excessive there is loss to non-assenting stockholders in that their legally recognized expectation of dividends is measurably defeated. It seems to be of special significance that the corporation is in financial straits and the directors and officers are in effect preferring themselves, or in plainer language "getting from under"

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[165]Minor v. Mechanics' Bank of Alexandria, 26 U. S. 46, 69 (1828); Agnew v. United States, 165 U. S. 36 (1897); Dent v. Ferguson, 132 U. S. 50 (1899); Enzor v. State, 167 So. 336 (Ala. App. 1936), *cert. denied*, 167 So. 340 (Ala. Sup. Ct. 1936); Zuckerman v. People, 213 Ill. 114, 72 N. E. 741 (1904); Commonwealth v. Winegard, 119 Pa. Super. 78, 180 Atl. 160 (1935); Powell v. State, 82 Tex. Cr. 163, 198 S. W. 317 (1917).

[166]The high demand for managerial fidelity and activity, in prevention of unjust dissipation of corporate assets not only presently but also in the future in the interest, not merely of common stockholders but of preferred stockholders, made in the recent and epochal case of Ashwander v. Tennessee Valley Authority, 297 U. S. 288 (1935), by the Supreme Court of the United States, comes as an electric shock after the majority's complaisant acquiescence in the dispositions of management in the American Tobacco Company case (Rogers v. Guaranty Trust Co., 288 U. S. 123 (1933); and see Comments note 164 *supra*). Can it be that management, in effective "control" of a corporation, is held to the highest degree of diligence and foresight to protect corporate assets for the benefit present and future of stockholders when the persons managing have no personal gain to make and an Act of the Congress is in question (Ashwander case) but that their discretion is practically beyond challenge when these persons are filling their own pockets by the very action in issue and an act of corporate managers is in question (Tobacco Company case)? Or does the highest court of the land announce, in the Ashwander case, a different view of the function and extent of judicial review of management's discretion?

[167]People v. Lay, 193 Mich. 17, 476, 159 N. W. 299, 160 N. W. 467 (1916).

[168]Directors are held to knowledge of the financial condition of the corporation; it is their function to know. 3 FLETCHER, *op. cit. supra* note 12, c. 11, § 1059.

and leaving other investors "holding the bag".[169] This view is not surprising, since after insolvency the corporate assets are a trust fund for creditors and their rights, as well as those of stockholders, are infringed by the payment of compensation in excess of the value of services rendered.

3. Purchases for the Corporation

Directors and officers are liable civilly for secret profits made in the course of corporate transactions.[170] If they purchase from themselves and the price is fair, the transaction will stand;[171] but, if they purchase from themselves, they are liable for the excess paid above the fair and reasonable value.[172] Furthermore, they are liable for bribes received, when purchasing from others, especially where the interests of the corporation are not fully protected.[173] While directors and officers may be liable upon principles of negligence for purchasing from others at excessive prices, it is obvious that a much greater hazard exists when they make some personal gain thereby. In purchases for the corporation, the real subject of inquiry is the fairness of the price.

There is ample authority that, when a purchase is made and an excessive price is paid, the excess is fraudulently converted,[174] at least if the officers doing so make some personal gain by purchasing from themselves or by receiving a "split" from others for purchasing from them. As to the excess, there is no difficulty in bringing the transaction within the ancient formula of conversion.[175] Since corporate loss appears to be inevitable,[176] proof of intent to defraud is apparent; and this result seems to be as much assured where the officer makes no personal gain as it does where he makes such a gain. However, no criminal case is found where

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[169]People v. Lay, 193 Mich. 17, 476, 159 N. W. 299, 160 N. W. 467 (1916). Note also the same idea in State v. Woodbury, 132 Kan. 22, 27, 294 Pac. 928, 931 (1931), with respect to a bank president's withdrawing his own funds when the bank was in financial difficulties.

[170]BALLANTINE, CORPORATIONS (1927) 377-381; 3 FLETCHER, *op. cit. supra* note 12, c. 11, §§ 899, 900.

[171]BALLANTINE, CORPORATIONS (1927) 390-392; 3 FLETCHER, *op. cit. supra* note 12, c. 11, § 931.

[172]3 FLETCHER, *op. cit. supra* note 12, c. 11, §§ 950, 951; *id.* c. 58, § 5837.

[173]*Id.*, c. 11, §§ 892, 901. A purchase of bonds is really only another form of loan. See Walsh v. United States, 174 Fed. 615 (C. C. A. 7th, 1909).

[174]Agnew v. United States, 165 U. S. 36 (1897); People v. Cobb, 343 Ill. 78, 174 N. E. 885 (1931); Yoder v. State, 194 N. E. 645 (Sup. Ct. Ind. 1935); People v. Marcus, 261 N. Y. 268, 185 N. E. 97 (1933).

[175]*Ibid.*

[176]Of course, there is no actual loss in the sense required in fraudulent conversion, if capital is unimpaired and all stockholders assent. See note 101, *supra*. But watch the rights of depositors in savings banks. See note 97, *supra*.

personal gain was not present.[177] Since the officer must know that he cannot make a profit at the expense of the corporation, there is, in such a case, always "bad faith".[178]

Two of the cases on fraudulent conversion by purchases[179] represent variations of this abuse worthy of particular attention. In *People v. Cobb,* officers of an unincorporated benefit society maintained by members of the United Mine Workers of America were authorized to purchase groceries for needy families to the amount of $50,000. They purchased groceries of a value of $35,000 but paid $50,000 for them. They had arranged for a "split" of the excess, and a part thereof, by a circuitous route, found its way into their pockets. The Supreme Court of Illinois had no difficulty in affirming their conviction for embezzlement.

The other case involves the holding company evil and is connected with the collapse of the Bank of the United States.[180] The case is of particular interest, in the present connection, for its bearing upon the statement that in purchasing for a corporation the subject of inquiry is the fairness of the price, and upon the related aspects of loss to the corporation and gain to the defendant. The Bank of the United States had a number of subsidiaries of which, apparently, it owned all the stock. Several of the subsidiary corporations were involved in the transactions for which the conviction, for criminal misapplication, of Bernard K. Marcus and Saul Singer was obtained; but understanding of the points of immediate interest here may be facilitated by a somewhat condensed statement in which only two subsidiaries are mentioned.

The parent corporation, Bank of United States, had loaned to subsidiary *A* considerably in excess of legal limitations; and it became necessary to reduce these loans. The assets of this subsidiary consisted of real estate equities of "questionable value" and "on the downward road", the income from which would not pay the interest on a proposed bond issue for the purpose of reducing the loan from the parent company. Subsidiary *B* was in good financial

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[177]Gain might be to a corporation in which the officer is interested. Gain to the *agent* may appear otherwise than by his getting himself the 'property' converted, which may go to some other person with the *agent* indirectly securing an advantage, as where the 'property' is converted to the use of a corporation of which the defendant is an officer, shareholder, or employee, or to the use of a partnership of which he is a member. See note 144, *supra.* Compare People v. Marcus, 261 N. Y. 268, 185 N. E. 97 (1933) with these cases. The rule is the same civilly. 3 FLETCHER, *op. cit. supra* note 12, c. 11, §§ 913, 941, 944.

[178]Note the reasoning in Yoder v. State, 194 N. E. 645 (Sup. Ct. Ind. 1935). See note 140, *supra,* and text appertaining.

[179]People v. Cobb, People v. Marcus, both *supra* note 174.

[180]People v. Marcus, 261 N. Y. 268, 185 N. E. 97 (1933).

condition. Marcus was president and director of the Bank of United States and Singer was vice-president, director, and chairman of the executive committee. They were also "directors and the controlling power" in subsidiary *B*, and the "whole thing" in subsidiary *A*. In order to reduce the loans owed the parent by subsidiary *A*, they hit upon and carried through the plan of loaning $2,009,518.45 by the Bank of United States to subsidiary *B*, the solvent subsidiary. These funds were then used to buy, from subsidiary *A*, stock representing real estate equities of a book value of $1,200,000. Subsidiary *A* then used the funds to pay its loan owed to the parent corporation. The defendants were prosecuted, as officers of subsidiary *B*, for this purchase on behalf of subsidiary *B*. Two questions arise: Was there loss to subsidiary *B*? Was there gain to the defendants?

The majority of the Court of Appeals thought that loss was unnecessary under the applicable statute. Lehman, J., dissenting, thought that loss was necessary under the statute. Both seem to agree that there was no loss. Was there? It is argued that the defendants could have reversed the transactions at any time. This argument is peculiarly flimsy: restoration has never yet wiped out a larceny or fraudulent conversion, and intent to restore has without exception, been discarded as exoneration in embezzlement, misapplication, and abstraction. The contention that there was no loss is further to the effect that, since the Bank of United States owned all the stock of the subsidiaries, the transactions were really bookkeeping transactions by it with itself.

According to the majority opinion, subsidiary *B*, just prior to the transactions in issue, owed $1,014,726 to creditors. After the transactions, it had become indebted to the Bank of United States in the amount of $2,009,518.45 and had acquired additional assets of $1,200,000, if the *book value* of those assets before transfer to subsidiary *B* is taken. And even at that figure, those assets "on the downward road" were overvalued. Consequently, at the best, subsidiary *B* had, after the transactions, assets of $2,347,726 and liabilities, not counting capital stock, of $3,024,277.45; its capital was completely gone, and the rights of its creditors impaired. Prior to the transactions, creditors of subsidiary *B* could present $1,014,726 of claims against $1,147,726 of assets; but, after the transactions, creditors could present $3,024,244.45 of claims against $2,347,726 of assets. If this dilution of the claims of prior creditors of subsidiary *B* did not represent a real loss to beneficial owners of that corporation, there is no instance of such loss in the books. It might be argued that the claims of the original creditors of subsidiary *B* were prior liens to that of the Bank of United

States on account of the loan to that subsidiary. But that contention means little. Subsidiary *B* had been reduced from a solvent going concern to an insolvent concern. It might be that the claim of the Bank of United States would have been disallowed entirely, but such a result could come only after litigation or future action of the officers in reversing the transaction. This litigation would itself impair the solvent going-concern status of the subsidiary; and, anyway, the law of fraudulent conversion deals with potential losses, not actual losses. It ought to be remembered that a thief who steals a horse can reverse the transaction and restore the horse, as likewise a bailee who converts a horse can restore the horse; and, of course, the 'owner' can recover his horse by a writ of replevin. The interests of the creditors of subsidiary *B* were equally and similarly jeopardized. It makes no difference that the benefits of the transactions went to the Bank of United States, or rather to the depositors of the Bank of United States; the funds represented were applied otherwise than to the use of the beneficial owners of the subsidiary corporation,[181] who upon impairment of its capital were its creditors, if, since the subsidiary was a banking corporation, they were not before.

The dissenting opinion displays much confusion also about there not being any gain to the defendants. It is not necessary that they should have received any money personally or manually. It is enough that the benefits went to a corporation in which they were largely interested. Moreover, they did receive a distinct personal advantage, one which it is impossible to believe did not provide the sole motive for the whole affair: as Lehman, J., said, "that plan may have staved off immediate disaster to the bank and permitted it to continue in business for some months". Thereby the defendants' personal control was protected for their benefit.

4. Payment of Dividends

A. From Capital

Directors are civilly liable for paying dividends out of capital.[182] While there is much authority to the effect that a dividend received by a stockholder in "good faith" cannot be recovered from him, no[183] such rule applies to a stockholder who is also a director;

[181]The question is: May those controlling corporations invoke the separate corporate *persons* to avoid personal liability, and then have it disregarded when that is necessary to avoid the burden of its duties to its beneficial owners?

[182]BALLANTINE, CORPORATIONS (1927) 526; 11 FLETCHER, *op. cit. supra* note 12, c. 58, § 5329.

[183]12 FLETCHER, *op. cit. supra* note 12, c. 58, § 5423. Such a rule does not affect the liability of the directors for paying the dividend to stockholders

for a director is "bound to know the condition of the corporation affairs".[184] Since the board of directors only can declare a dividend, it seems that other officers are liable only when they aid and abet a majority of the board, or cause, by misleading reports, the board to declare the dividend when there are no available earnings.[185] Such a dividend is an impairment of capital and infringes creditors' rights, as well as being a loss to non-assenting stockholders. However, such payment can not be fraudulent conversion, if solvency is not affected and all stockholders assent, whatever other breach it might be.[186] The board of directors have wide discretion in determining whether or not earnings exist for the payment of dividends;[187] but this discretion is subject to judicial correction, and, if erroneous, the approval of a majority of stockholders does not validate its determinations.[188] Expenses, debts, borrowed money, reserves, valuation of property, and capital may be inquired into judicially.[189] As discretion in declaring and paying out dividends is subject to judicial control, so discretion in withholding them also is a justiciable matter.[190]

That corporate 'property' can be fraudulently converted under the guise of a dividend is clear.[191] Payment of dividends out of capital infringes creditors' rights; and, if less than all the stockholders assent, it infringes the rights of the non-assenting stockholders. It is to be noticed that, in the payment of an improper dividend, there is not a withdrawal of corporate 'property' by transferring it to persons having no claim whatsoever but a switching of corporate 'property' from one or more classes of claimant to another class.

B. On Watered Stock

a. What is Watered Stock?

Dividends upon watered stock present a problem as yet unsolved: no criminal case is found and the civil cases are indecisive. "Watered stock is stock issued as fully paid-up when in fact the consideration accepted by the corporation was less than the par

from whom it cannot be recovered. BALLANTINE, CORPORATIONS (1927) 535-539.

[184]12 FLETCHER, *op. cit. supra* note 12, c. 58, § 5426.

[185]See cases cited *supra* notes 18-20, and text appertaining.

[186]See cases cited *supra* note 101.

[187]11 FLETCHER, *op. cit. supra* note 12, c. 58, § 5336.

[188]*Id.* § 5329.

[189]*Id.* §§ 5335, 5337, 5339-5345.

[190]*Id.* § 5325; Dodge v. Ford Motor Co., 204 Mich. 459, 170 N. W. 668 (1919).

[191]12 *id.*, c. 58, § 5442; Taylor v. Commonwealth, 119 Ky. 731, 75 S. W. 244 (1903). See State v. Holen, 63 S. D. 151, 257 N. W. 108 (1934).

value of the stock or fictitious."[192] If the term can be applied to no-par stock, it is to such stock issued as fully paid-up when the consideration fixed has not been fully paid. Although "a wide margin . . . . will always be allowed under the good-faith rule for honest differences of opinion as to value",[193] stock actually watered is illegally issued:[194] its issue can be enjoined;[195] it can be cancelled in a proper proceeding;[196] the subscriber can be compelled to pay the amount represented by the water;[197] its issue is a fraud upon non-assenting stockholders and upon subsequent creditors;[198] and the directors and officers may be held personally liable for issuing it.[199] If issuance is to the directors and officers themselves the act of issuance is fraudulent as distinguished from being merely illegal; for personal gain is the essence of bad faith and fraud.[200] Notwithstanding the tremendous discretionary powers afforded directors by the no-par device, they are still fiduciaries and are liable for bad faith when they act for their own interests in conflict with those of the other stockholders and of the creditors; and so they must issue this stock too in good faith and without fraud.[201] Similar rules apply to the sale of treasury stock.[202]

b. Legality of Dividends on Watered Stock

The purport of the authorities is that such stock is not void but voidable. Are dividends on it legally paid out? A recent case might seem to hold that they are.[203] The case involved the rights of bondholders with respect to dividends paid on *all* the stock is-

[192]BALLANTINE, CORPORATIONS (1927) 653; 11 FLETCHER, *op. cit. supra* note 12, c. 58, § 5199.

[193]BALLANTINE, CORPORATIONS (1927) 660; 11 FLETCHER, *op. cit. supra* note 12, c. 58, § 5214.

[194]BALLANTINE, CORPORATIONS (1927) 655, 666; 11 FLETCHER, *op. cit. supra* note 12, c. 58, § 5214.

[195]BALLANTINE, CORPORATIONS (1927) 668; 11 FLETCHER, *op. cit. supra* note 12, c. 58, § 5253.

[196]*Ibid.*

[197]BALLANTINE, CORPORATIONS (1927) 671, 679; 11 FLETCHER, *op. cit. supra* note 12, c. 58, §§ 5234, 5244.

[198]BALLANTINE, CORPORATIONS (1927) 668; 11 FLETCHER, *op. cit. supra* note 12, c. 58, §§ 5202, 5222, 5228.

[199]11 FLETCHER, *op. cit. supra* note 12, c. 58, § 5243. If the issue is fraudulent, no statutory basis of liability is necessary.

[200]3 FLETCHER, *op. cit. supra* note 12, c. 11, §§ 958, 1108; 11 *id.* c. 58, § 5231.

[201]BALLANTINE, CORPORATIONS (1927) 685-696; 11 FLETCHER, *op. cit. supra* note 12, c. 58, §§ 5259, 5260. The principle is clearly recognized, although courts may have been somewhat lax and "reluctant" to enforce it rigidly. About the only clear meaning of bad faith and fraud that can be gathered from all the cases and authorities, is personal gain. See, *inter alia*, citations to FLETCHER, *supra* note 200.

[202]BALLANTINE, CORPORATIONS (1927) 681; 11 FLETCHER, *op. cit. supra* note 12, c. 58, §§ 5204, 5237.

[203]United Light & Power Co. v. Grand Rapids Trust Co., 85 F. (2d) 331 (C. C. A. 6th, 1936).

sued, none of which had been "paid for and represented no value except that which might accrue from appreciation in the value of the property". An impairment of capital was urged; but the court held that there was no impairment of capital; for, since nothing had been received for the stock, there was nothing to impair and, accordingly, there was no insolvency until the assets went below the amount of debts. The complainant's contention was that no dividends could be paid until assets had been built up to the par value of the shares plus the debts. On this aspect of the case, the opinion reads: "We have been cited to no case and can find none where the failure of a corporation to keep assets in reserve sufficient to offset the par value of its stock is an impairment of capital to the extent of insolvency where the stock itself has not been paid for. Reduced to its simplest terms, this would mean that a corporation could impair actual working capital which never existed. This is paradoxical. We apprehend that in cases seeming to hold to the contrary the courts have assumed 'par value stock' to mean fully paid up stock. Situations frequently arise where the receiver of an insolvent corporation may require delinquent stockholders to satisfy their unpaid subscriptions for the benefit of creditors, but we have no such case." But the force of this argument as a matter of general principle is entirely broken; for the decision expressly is rested upon the fact that "the original bondholder and stockholder, Westinghouse, Church, Kerr & Co., was identical and it of course knew that the bonds were not issued upon the faith of the fully paid-up stock, and that it could not rely thereon for the payment of its debts." In support of the proposition that dividends may be paid from net current earnings so long as there is no impairment of assets actually received for stock, the court cited a number of cases. These will now be looked at.

One of the cases thus cited is a decision of the Supreme Court of the United States[204] holding that a dividend paid from capital could not be recovered from a stockholder who received it in good faith not knowing anything of the impairment. The case has nothing to do with a stockholder who is a director or officer or one who knows of the impairment. Two California cases are cited, one of which relies on the other. This other case[205] deals with dividends by a corporation having wasting assets and, therefore, is of little general worth on the question. A number of other cases are cited which rely on *Goodnow v. American Writing Paper Co.*,[206] which also is cited. This last-named case is then the real basis of the doctrine. *It is not a general authority for the proposition.*

[204]McDonald, Receiver v. Williams, 174 U. S. 397, 407 (1899).
[205]Excelsior W. & M. Co. v. Pierce, 90 Cal. 131, 140, 27 Pac. 44 (1891).
[206]73 N. J. Eq. 692, 69 Atl. 1014 (1908).

In the first place, the decision there[207] purports only to be a construction of the words "surplus or net profits" in a specific New Jersey statute. In the second place, the reasoning of the following language is especially faulty: "It may not infrequently happen that stock is issued on which avowedly only a partial payment is made of the amount subscribed, which is therefore subject to further calls. We cannot think that in such a case, where the company prospers, there are no net profits available for dividends until the earnings accumulate to an amount equal to the par value of the shares. The complainant's brief concedes this, and the concession seems quite fatal to his argument." It is all well and good for the complainant's concession to conclude him. But why should any complainant make such a concession? A *bona fide* subscription only partially paid and by its terms "subject to further calls" is vastly different. There is, in such an instance, no secrecy and no deceptive device. The stock does not purport to be fully paid-up. There is no doubt of the subscriber's agreement to pay the additional sum. Surely, in this study, we have seen enough concerning secrecy and fictitious form of transactions as evidence of fraud. Why then confuse a simple straight-forward case of partial payment with an issue fictitiously represented as fully paid-up? Paying dividends on the former is something far removed from paying dividends on the latter. In the third place, the court said at the end of the opinion: "It is quite enough to say that the complainant filed his bill as a holder of preferred as well as common stock and does not pray for a decree adjudging the preferred stock invalid. The prayer is only that the resolution for a dividend may be decreed to be unlawful, null and void, and for an injunction. There is not even the usual prayer for general relief. It is therefore unnecessary to consider the question whether the issue of the preferred stock is not within the rule established in Hackensack Water Co. v. DeKay, 36 N. J. Eq. (9 Stew.) 548." Thus, the door was left open to preventing payment of the dividend on the watered preferred by a proper suit to cancel the issue. And, obviously, the fact that a stockholder had at his own suit no remedy does not prove that payment of the dividend would have been legal. If a cashier of a solvent corporation should take a hundred dollars of corporate money and spend it at the races, a stockholder or creditor could bring no suit, and yet the cashier would be an embezzler.

The *Goodnow* and the *United Light & Power* cases do not show that paying dividends on watered stock is legal. Authorities generally on watered stock make a contrary impression, which is

[207]In the Goodnow case.

rendered more vivid by the high demands made on directors in recent cases, of which *Ashwander v. Tennessee Valley Authority*[208] is a pre-eminent example. If assets representing capital cannot be impaired where nothing has been received by the corporation, it is equally true that the conception of a dividend is that of a payment for contribution made. If the stockholder has contributed nothing, nothing has been received by the corporation from him which entitles him to receive a dividend from it. Especially is this true of the original subscriber who knows the stock is watered when he acquires it. The *Goodnow* case intimates that the watered issue might have been cancelled in an action asking for that relief. The *United Light & Power* case intimates that, if the original bondholders had not known of the watering of the stock, relief might have been granted against payment of dividends on it; the court merely refused to hold that the just expectations of a bondholder have been infringed, when he knew that the stock was watered and did not have in fact any expectation of relying upon receipt of full payment by the corporation. Both cases indicate that stockholders and creditors do have claims of some kind against the payment of dividends on watered stock.

The *Goodnow* case is in accord with a view appropriate to the improper issuance of a negotiable instrument by an agent. Unless the instrument is cancelled, it may be recognized for the protection of transferees. Since corporate stocks are transferable, the same view is reasonable with respect to them. As much is suggested by the above quotation taken from the end of the opinion. Let us suppose, as we are justified in doing from the *Goodnow* and the *United Light & Power* cases,[209] that an issue of watered stock may be cancelled but that payment of dividends thereon cannot be enjoined so long as the stock is outstanding. Does this supposition mean that the act of the directors in paying dividends thereon is lawful? If an agent issues a check of his principal to pay the agent's own debt, the check may be cancelled if the payee is privy to the fraud. If the payee is innocent, he may enforce payment of the check in reliance on the agent's implied authority. And, of course, a holder in due course can enforce payment of the check. Would the fact that the principal did not act to obtain cancellation, before the payee had negotiated the check to a holder in due course, prevent the agent's act from being an embezzlement? If the check is enforceable by the payee, is the agent any less an embezzler? Clearly he is not.[210] Why then should it be thought that the act

[208]297 U. S. 288 (1935).

[209]See also authorities cited *supra* notes 195-199.

[210]Carter v. McClaughry, 183 U. S. 365 (1901); Territory v. Meyer, 3 Ariz. 199, 24 Pac. 183 (1907); *Ex parte* Hedley, 31 Cal. 109 (1866); Kossa-

of a board of directors in paying dividends on watered stock is lawful merely because the remedies, which are in effect, as an action to enjoin payment of dividends is, aimed at the holders of the stock while it is still outstanding, are doubtful? Are these remedies much less effective than those of a principal who seeks to avoid, in the hands of a holder, a check improperly issued by his agent? Rather it seems reasonable to suppose that it is the duty of the board to procure the cancellation of watered stock than that it is their right to pay dividends on it.

These reflections suggest that it is an error to look for the rights of stockholders and creditors against the payment of dividends on watered stock solely with reference to remedies against, or which operate in effect against, the holders of the watered stock. The situation is analogous to that of the principal whose agent improperly issues a check. The principal's remedies against the holder of the check may be limited or he may have none. The agent, nevertheless, violates a duty to the principal by his unauthorized act of issuing the check. The absence of remedy which defeats the third party does not negative the breach of duty by the agent.[211]

c. Payment of Dividends on Watered Stock as Fraudulent Conversion

Since the fraudulent conversion of embezzlement can be committed by making loans, by making purchases, by paying salaries, and by paying dividends from capital, it is, by a parity of reasoning, not far-fetched to conclude that the same fraudulent conversion can be committed by paying dividends on watered stock. Granted that such dividends are unauthorized, if those who declare and pay them, or cause them to be declared and paid, also receive a personal benefit, as by getting the funds themselves in whole or in part, or by retaining their control thereby, or by receiving a benefit through another corporation or other enterprise in which they are interested, the evidence of fraud accumulates until it approaches con-

kowski v. People, 177 Ill. 563, 53 N. E. 115 (1899); State v. Johnson, 109 Kan. 239, 199 Pac. 104 (1921); State v. Bussa, 176 La. 87, 145 So. 276 (1932); Commonwealth v. Nichols, 257 Mass. 289, 153 N. E. 787 (1926); State v. Mispagel, 207 Mo. 557 (1907).

If the principal is a corporation, the very agent who issues the principal's check to pay his own debt may be required to pay it on behalf of the corporate principal. Yet he is guilty of embezzlement by issuing and paying the check. Hence, there is nothing strange in holding the acts of directors in paying a dividend on watered stock unlawful merely because they cannot defeat the third party, the stockholder.

[211]Directors may be personally liable for issuing watered stock. 11 FLETCHER, *op. cit. supra* note 12, c. 58, § 5243. This liability is distinct from that of the subscriber to pay the amount of the water.

clusiveness. The pertinent question, hence, is: By what test is it to be determined whether or not the declaration and payment of the dividend by the directors is authorized? Two situations suggest themselves: first, where the directors declaring and paying the dividend did not issue the watered stock; second, where the directors declaring and paying the dividend did themselves issue the watered stock.

a'. Authority of Directors

In the first situation, if the directors have no knowledge that the stock is watered, their act in declaring and paying the dividend appears to be entirely proper in the performance of their functions. If, however, they have knowledge, or notice, that the stock is watered, it ought to be their duty, owing to the corporation the benefit of which inures to the *bona fide* stockholders and creditors, not to declare and pay dividends on the watered stock until the validity of such stock is judicially established. It is the duty of directors, for the prevention of unjust dissipation of corporate 'property' in the interest of stockholders, to contest the validity of Acts of the Congress before entering upon transactions.[212] Why then is it not their duty to contest the validity of watered stock before paying dividends upon it? If there be no means whereby the directors themselves can institute such an action, it should be their duty to defer the declaration and payment of dividends on such stock, until the claim of the holders to receive such dividends is presented and determined in a proper suit. If the validity of the stock and the claim of its holders to receive dividends are upheld, then the directors may proceed to declare and pay dividends with full legal warrant. If the invalidity of the stock is adjudged, the directors then have full warrant to refrain. If the proposition that it is the duty of directors to safeguard corporate assets against unjust dissipation be accepted, it is hard to imagine that they are authorized to preclude the rights of other stockholders and of the creditors by declaring and paying dividends when the claim to receive them by the holders of the watered stock is doubtful. If it be thought that safeguarding the corporate assets is merely a matter of directoral discretion, it is to be remembered that such was the very contention made with reference to directors' contesting the validity of an Act of the Congress and yet the Supreme Court of the United States rested its decision on their duty to do so.

In the second situation, it should make no difference whatever be the remedies against the holders of the watered stock. There are some remedies of undetermined scope against these stockhold-

[212]Ashwander v. Tennessee Valley Authority, 297 U. S. 288 (1935).

ers, but it should make no difference if there were none and if they could enforce a claim for dividends. The apt analogy again is that of an agent improperly issuing a check. Even if the check can be collected by the payee or any other holder, the agent's act is still unlawful, since he issued the check unlawfully and thereby made the payment unavoidable. Thus, if directors knowingly issue watered stock, they are not exonerated because holders of the stock have claims which they can enforce. The directors must stand upon the propriety of their act of issuing the watered stock. Although "a wide margin . . . . will always be allowed under the good-faith rule for honest differences of opinion as to value", can any one seriously contend that directors[213] have any authority to issue stock which unmistakably is watered or that they break no fiduciary obligation when they do so? Or that a majority of stockholders have power to ratify their doing so?

b'. Loss to the Corporation

For an act to be a fraudulent conversion, it must work loss or risk of loss to the *principal*.[214] When payment is made to a person having no claim at all, the loss is evident; but, when funds are switched from one claimant against the *principal* to another claimant against him, the loss to the *principal* is not so completely obvious. It seems more like a loss to the deferred claimant. Switching from one claimant to another is what occurs when dividends are paid on watered stock, for the holders of watered stock do have some claim albeit a voidable claim; and there is an appearance that the loss is suffered by a certain class, or classes, of stockholder or by the creditors, or both, and not by the corporation itself. However, it must be remembered that a loss to a corporation, in the sense in which loss is considered in fraudulent conversion, is a diminution of corporate assets in such wise that it defeats legally recognized expectations of stockholders or of creditors or, what is

[213]Directors only have been discussed. Those in "control" may be liable as aiders and abettors of the directors who do the withdrawing by declaring the dividend; and likewise other officers who are not directors. See notes 26 and 27 *supra*.

If the directors have issued watered stock upon which they may be compelled to pay dividends, the act of conversion is the issuance of the stock which makes the withdrawal later of corporate funds unavoidable. See Kossakowski v. People, 177 Ill. 563, 53 N. E. 115 (1899); Commonwealth v. Nichols, 257 Mass. 289, 153 N. E. 787 (1926). If the directors declaring the dividend are not the same as those issuing the stock and the second set of directors had knowledge of the invalidity of the stock and could have avoided it or did not contest an invalid issue, the conversion is the declaration of the dividend. Payment is the loss, or at least the risk, which inevitably follows that act.

[214]State v. Disbrow, 130 Iowa 19, 25, 106 N. W. 263, 265 (1906); State v. Cohoon, 206 N. C. 388, 174 S. E. 91 (1934); Prinslow v. State, 140 Wis. 131, 121 N. W. 637 (1909).

the same thing, infringes their claims.[215] With this definition of loss in mind, let us see whether switching corporate funds from one claimant to another, in contradistinction to payment to one having no claim, is a loss to the corporation. If it is, such an act conforms to the definition of fraudulent conversion.

c'. Claims of Stockholders and Creditors Against Overpayment of Others

The matter resolves itself into an inquiry whether a stockholder or creditor has a claim not only that he be paid himself but also that others claimants shall not be overpaid. If any one has such a claim, the overpayment of another is a breach of duty owed to the first claimant; and the overpayment is such an occurrence as is a fraudulent conversion of the funds applied to it, namely, a diminution of corporate assets in violation of a claim of stockholders or creditors, or, otherwise put, in violation of a duty of the corporation to them not to make the overpayment. Apparently creditors have, after insolvency, such a claim against overpayment of others.

The weight of authority is that, when insolvency supervenes and trust claims of creditors on assets become operative, a preference is invalid.[216] Where the preference is permitted, it, nevertheless, must be made in good faith[217]—good faith, in this connection, meaning that the claim preferred must be one for full value received by the corporation.[218] If directors and officers are also creditors and, after insolvency, prefer themselves, the great weight of authority is that the preference is invalid.[219] While there is some authority that they may prefer themselves as creditors,[220] many of the cases cited for the proposition do not sustain it;[221] and the rule is further limited by requirements that their claims must present some superior equity[222] and must be for full value received by the corporation.[223] Insolvency does not supervene so long as the corporation continues to operate as an actual going concern;[224] but

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[215]See *supra* note 101, and text appertaining.

[216]15 FLETCHER, *op. cit. supra* note 12, c. 63, § 7422.

[217]BALLANTINE, CORPORATIONS (1927) 731, 732; 15 FLETCHER, *op. cit. supra* note 12, c. 63, § 7424.

[218]15 FLETCHER, *op. cit. supra* note 12, c. 63, § 7424.

[219]BALLANTINE, CORPORATIONS (1927) 734-737; 15 FLETCHER, *op. cit. supra* note 12, c. 63, §§ 7468, 7469. The rule seems to be the same with respect to preferences to stockholders. BALLANTINE, CORPORATIONS (1927) 737, 738.

[220]15 FLETCHER, *op. cit. supra* note 12, c. 63, § 7470. Fletcher calls this a "miserable doctrine". 15 *id.* at p. 692.

[221]*Ibid.*

[222]*Id.* § 7471.

[223]*Id.* §§ 7424, 7470, 7471.

[224]*Id.* § 7425.

the duty to act with reference to a state of insolvency and the rights arising by reason thereof come into play as soon as the directors and officers have knowledge that insolvency will ensue, although that stage has not yet been reached.[225] Universally, the conduct of directors and officers in trying to save themselves, after knowledge of impending insolvency, by means of claims shady in any regard, is condemned.[226]

Some criminal authority on the subject exists. In *Spalding v. People*, which is a case of using funds held only for other specific purposes of a university to pay, as it was contended, current expenses, the court said: "But it is not intended to be said that the mere unlawful conversion of one fund to another for the supposed benefit of the university would have been an embezzlement under the statute in question."[227] This, however, was a public corporation and the rights of stockholders and creditors did not enter. In *State v. Hattrem*,[228] the existence of other interests than those of the defendant on the part of other stockholders or of creditors was treated as essential for embezzlement to have occurred. In the case of an assignee for the benefit of creditors who was charged with embezzlement for paying his own claim instead of that of a preferred claimant,[229] the decision was not put squarely on that ground; but there was a dispute which the court did not, at least fully, decide whether or not the other claimant had a preference. In *Lemaster v. People*,[230] there was a discussion of the act by an officer, in a one-man corporation, by which, after insolvency, he prefers himself as a creditor; but the discussion went off on the question whether the defendant's claim for back salary was *bona fide* or not. In *State v. Woodbury*,[231] shifting a credit from one depositor's account without a withdrawal by him to another depositor's account without a deposit by him was held to be embezzlement; and it was further suggested that the president's cashing his own check, immediately prior to the bank's closing, and thereby getting a part of the little money left in the bank, even if he had the full amount of the check on deposit, might have been such a preference of himself as would amount to fraudulent conversion of the money. In *Taylor v. Commonwealth*,[232] it was held that

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[225]15 FLETCHER, *op. cit. supra* note 12, c. 63. § 7469.

[226]Note the reasoning in LeMaster v. People, 54 Colo. 416, 131 Pac. 269 (1913); State v. Woodbury, 132 Kan. 22, 27, 294 Pac. 928, 931 (1931); People v. Lay, 193 Mich. 17, 476, 159 N. W. 299, 160 N. W. 467 (1916).

[227]172 Ill. 40, 59, 49 N. E. 993, 999 (1898).

[228]140 Ore. 371, 13 P. (2d) 618 (1932).

[229]People v. DeLay, 80 Cal. 52, 56, 22 Pac. 90, 91 (1899).

[230]54 Colo. 416, 425, 131 Pac. 269, 272 (1913).

[231]132 Kan. 22, 24, 25, 27, 294 Pac. 928, 930, 931 (1931).

[232]119 Ky. 731, 747, 748, 75 S. W. 244, 250 (1903).

knowingly shunting corporate funds to stockholders by means of dividends when the capital is impaired is embezzlement. "The inquiry in this case, therefore, should have been, first, to learn whether the corporation had assets on May 14, 1901, which might lawfully be used in paying dividends; that is, a surplus in fact, whether or not in name. If it had, then the motive of the directors in this case in paying the dividend is immaterial. If it had not, the question of motive becomes important and controlling. If the directors believed they had the right to pay the dividend, or if they paid it in utter ignorance of their legal right, but without fraudulent motive against others interested in the assets of the corporation, they can not be guilty of the crime charged. On the other hand, if they at the time knew that there were not funds belonging to the corporation which could legally be used in paying the dividend, and passed the resolution declaring it, and paid it with the fraudulent purpose of converting to their own use the money of the corporation, using the form of declaring the dividend as a blind to cover their peculations, then they are guilty under the statute."

It appears, from the foregoing authorities, that overpaying one creditor by way of preference, after insolvency has rendered the creditors' rights in the nature of those of a *cestui que trust* operative upon the corporate assets, is such a violation of deferred creditors' claims as beneficial owners that the act of preference is a fraudulent conversion. It is clear that paying a dividend after assets representing capital have been impaired is, if knowingly done, a fraudulent conversion. But these authorities do not answer the question whether paying a dividend on watered stock, when the assets actually received therefor are intact, is a sufficient violation of creditors' claims to make the act a fraudulent conversion. And they do not answer the question whether such a payment violates any claim of prejudiced stockholders. The *Goodnow*[233] and the *Union Light & Power*[234] cases leave the claims of other stockholders and of creditors in doubt, but intimate that there are claims on behalf of those who do not know of or assent to the watering.

d'. Problems Involved in Determining Overpayment

Definition of a claim on the part of one person that overpayment shall not be made to another person presents no novel judicial problem. In addition to the claims of creditors, after insolvency,

[233]Goodnow v. American Writing Paper Co., 73 N. J. Eq. 692, 69 Atl. 1014 (1908).

[234]Union Light & Power Co. v. Grand Rapids Trust Co., 85 F. (2d) 331 (C. C. A. 6th, 1936).

against preferences to other creditors and against dividends to stockholders, there is the well-established rule against overpaying on purchases.[235] However, determination of whether or not a claim against overpayment has been infringed embraces determination of the scope of the claim overpaid. This is a somewhat different and possibly a more difficult judicial task than that presented when payment is made to a person having no claim at all. In the latter instance, merely the existence or non-existence of a claim is in issue. In a case of overpayment, the extent also of the claim must be fixed. It is here that difficulty and confusion arise in regard to dividends on watered stock. The claims of other stockholders and of creditors against such dividends are undefined, because the claim of holders of watered stock to receive dividends is undetermined. Their stock is not void but voidable; they apparently have some kind of claim to receive dividends but just what no one knows; and yet it is true that the very conception of a corporation implies that those who receive any kind of payment from it are entitled thereto only by virtue of full value received from them by the corporation. With this confusion as to the nature and extent of the claim of holders of watered stock to receive dividends existing, it has been impossible to tell whether they have been overpaid or not; in fact no serious effort seems to have been made by the courts to do so. Hence, although it is everywhere implicit in the authorities that stockholders and creditors have claims against overpayment of some stockholders by means of dividends without just and equal contribution to the corporation and although the validity of watered stock is conjectural, still, since no one can tell how much or when a holder of watered stock has been overpaid, no one knows who has been injured by such an overpayment. A little aid may be had by looking at some other examples of overpayment.

Overpaying a claim arising from a purchase for the corporation at an excessive price is embezzlement.[236] However, the amount of the *bona fide* claim of the seller is regarded as definitely ascertainable; for there is a long legal development of the doctrine of reasonable value of goods sold and delivered. On the theory that, if an assignee for benefit of creditors pays himself at the expense of preferred claimants,[237] he is guilty of embezzlement, there is an instance of switching funds from one claimant to another; but the claim paid and the claim deferred are of definite amount.

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[235]Agnew v. United States, 165 U. S. 36 (1897); People v. Cobb, 343 Ill. 78, 174 N. E. 885 (1931); Yoder v. State, 194 N. E. 645 (Sup. Ct. Ind. 1935); People v. Marcus, 261 N. Y. 268, 185 N. E. 97 (1933).

[236]*Ibid.*

[237]People v. DeLay, 80 Cal. 52, 22 Pac. 90 (1899).

Where a bank credit was switched from one depositor to another,[238] claims of accurately defined scope and character were affected. If the overpayment is made on a debt, it is possible to tell the scope of the claim overpaid, and to see the overpayment clearly. But the claim of a stockholder to dividends is nebulous as compared with the claim of a creditor to be paid; and the claim of a stockholder that another stockholder shall not be overpaid is problematic, while a creditor's claim against preferences has been the subject of attempts at least at definition.

The lack of definition of the claims of prejudiced stockholders and of creditors against payment of dividends on watered stock and the corresponding lack of definition of the claim of holders of watered stock to receive dividends is, to use Fletcher's word anent directors' and officers' conduct in preferring themselves as creditors after insolvency, a most "miserable" part of present-day corporation law. "The evolutionary phase of the modern corporation in recent legal history has been both protracted and confused. Protracted, because it has been accomplished not by any great change either in concept or in statutory enactment, but rather by a long process of grant of management powers piecemeal. The aggregate of these various grants makes up the charter of almost absolute power which the control, commonly through management, asserts today. Confused, because the various accretions of power appear partly in statutory amendments over more than a century, partly in decisions purporting to declare the common law; partly in statutory enactments which purport to recognize or declare the common law; partly in clauses inserted in the charters; partly in powers merely assumed by lawyers and managements which, becoming traditional, work their way into the system."[239] "We are now faced with the question of securing on the one hand the benefits of continuous, compact, and able direction, and of avoiding on the other the hazard of unchecked power, whose strength is used in its own, rather than in the corporate and public interest."[240] By means of the no-par device and other devices whereby, it is said, the beneficial owner has consented in advance to the widest variety of changes in his rights and expectations, these have been confused until they seem to vanish.[241]

However, to assert generally that paying dividends on watered stock is legal implies the following propositions: (1) That the

[238]State v. Woodbury, 132 Kan. 22, 294 Pac. 928 (1931).

[239]Berle and Means, *op. cit. supra* note 23, at 127, 128.

[240]Ripley, Main Street and Wall Street (1927) 131, quoting A. A. Berle, Jr.

[241]Ballantine, Corporations (1927) 685-696; 11 Fletcher, *op. cit. supra* note 12, c. 58, §§ 5259, 5260; Berle and Means, *op. cit. supra* note 23, bk. II, c. 8.

holders of stock may properly receive payment from the corporation without making, or binding themselves to make, full proportional contribution thereto. (2) That creditors not knowing of the watering have no claim that capital be maintained to its purported amount. (3) That a stockholder has no claim that another stockholder shall not share above the due proportion of his contribution. (4) That directors are authorized to pay out corporate funds to those from whom the corporation has not received full value and otherwise than in proportion to the value actually received. (5) That directors owe no duty to the corporation to safeguard its assets (a) against payment to those having a doubtful claim to receive payment, and (b) against payment, in excess of the just amount of the claim, to those having some claim. If these propositions are correct, the directors may apply the corporate 'property' for the benefit of other persons than the *bona fide* creditors and stockholders, and even for their own benefit. But these propositions are at variance with the fundamental principle that corporate 'property' belongs to the corporation and that the directors are fiduciaries to manage the corporate 'property' and to apply it to the *bona fide* claims of creditors and stockholders.[242] To say that the whole matter is one of directoral discretion is in effect to make the corporate 'property' over to the directors. To say, as must be said, that the matter is one involving directoral discretion, but a discretion subject to judicial control, is to announce that (a) the claim of holders of watered stock to receive dividends both as to its nature and as to its extent, that (b) the claims of creditors and other stockholders against payment of such dividends, and that (c) the authority and corresponding duties of directors, must be defined. This task of definition is precisely what needs doing and what the courts have hitherto failed to do.

The task is a proper one for the judicial process. The basic claims and duties have always been recognized through the very conception of the nature of the corporation, through the fiduciary relations which directors, officers, and those in "control" are held judicially to sustain, and through adjudication that beneficial ownership is in the creditors and stockholders. Courts have intimated that the claims of holders of watered stock are defective, that creditors and other stockholders do have claims of some character

[242]It is as impossible to believe that a stockholder's claim to dividends is bona fide when he has not paid, or agreed to pay, for his stock in full as it is to believe that a person's claim for $50,000 is bona fide when he has sold $35,000 worth of groceries for $50,000 in collusion with another's agent. See People v. Cobb, 343 Ill. 78, 174 N. E. 885 (1931). A payment to a holder of watered stock may be to a stockholder but not to a bona fide stockholder. Do directors have authority to create and then to pay claims tainted with bad faith?

against its issuance and the payment of dividends on it, and that directors break their fiduciary obligations in issuing it. The further delineation of these claims and duties is unmistakably the precise business for which courts exist. They have, in the corporate concept and in the principles of the fiduciary relation and of fraud, the necessary tools for formulating the needed definitions, and they have long been familiar with ascertaining values. There is no reason why courts should not be guided by that judicial rectitude and acumen which they have so often displayed in the cases involving fraudulent loans, or why they should not enter upon the task of defining the rights and obligations with respect to dividends on watered stock by making, in aggravated cases, an "impressive mark of disapprobation" through criminal prosecutions. While there is some conjecture that property rights are to be defined first in civil cases and then later to be protected by criminal sanctions, the briefest glance at the history of our law will show that the criminal law has from the first been the protector of property rights, *even it seems before civil remedies were developed.*

RE-THINKING NEGLIGENCE

*Julian P. Alexander**

I. The Myth of Assumption of Risk

The fundamental principles of negligence have undergone so many changes when applied to the relation of master and servant that one should find it helpful to re-examine them. Some confusion has been caused by complicating the simple principles of negligence, seen as founded *ex delicto*, with theories alleged by many courts to relate to reciprocal obligations sounding in implied contract.

Most simply stated, negligence and duty are correlative terms. Since the duties owed by the master to his servant have been held to be unique, a body of doctrines has been judicially developed with reference to which liability is to be adjudged. Divergence of thought has arisen because the nature of the master's duty has not uniformly and exactly been defined. Nor has the responsibility of the servant been adequately recognized.

No right of action *ex delicto* arises save as the result of a breach of duty toward the injured party.[1] The master, of course, owes his servant the duty to use reasonable care to provide tools, appliances and places of work which are reasonably safe. This duty is more completely stated, however, when it involves the reciprocal duty of the servant to use reasonable prudence with respect to the place, appliances, tools, and other conditions of his employment. I shall undertake to show the importance of the factor of knowledge and how it permits the whole duty, both of the master and of the servant, to be summarily comprehended in the phrase, "requisite care."[2]

The basis of liability was, and always should be, expressed in terms of this duty, the breach of which gives a cause of action. So many of the early decisions gave emphasis to the conduct of the servant that our negligence cases have built up a great body of law with reference chiefly to the defenses available to the master.

What would have been considered negligence against, and a cause of action in favor of a third party, came to be explained away by various so-called doctrines when the injury was caused to an

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[1]G. M. & N. R. R. v. Sparkman, 177 So. 760 (Miss. 1938).

[2]The term "Requisite Care" is used herein as conveniently implying care commensurate with appreciated danger, appraised in terms of ordinary prudence and interpreted in the light of the attendant circumstances.

employee. Inconsistent fundamentally, it is not surprising that the courts in attempting to justify these doctrines were often inconsistent and confused in stating their *rationale.*

Disclaiming a dogmatic attitude, I propose to consider some of these inventions and invite thought and discussion by suggesting a re-appraisement of their value.

The first is

The Myth of Assumption of Risk as a Defense

Section 513 of the Mississippi Code of 1930[3] has been pointed to with pride by plaintiffs and viewed with alarm by defendants as abolishing the defense of assumption of risk in master and servant cases.

I venture to suggest that it operates to abolish no defense, for assumption of risk has never existed as a separate defense.

This doctrine (as it is more properly called) has two phases. It was applied (I) to all risks inherent in the particular employment and so considered as reasonably parcel thereof, they were deemed ordinary and usual; (II) to extraordinary risks (dangers) arising from a defect (breach of master's duty to use reasonable care) of which the servant had knowledge and appreciation. In the former case the master was not negligent, for ordinary risks were those inherent in the work and which remained after the master (who is not an insurer) has used reasonable care to make the place, tools and appliances reasonably safe.[4] Under (I) the master is not negligent for he has used due care and there is, therefore, no need to provide a defense. The master has fulfilled his duty to the employee, even though some risk or danger remains. Even though the employment is especially dangerous this principle applies.[5]

Under (II), since there is some defect or extraordinarily dangerous condition, the master has failed in his duty, for due care requires reasonable care to avoid extraordinary hazards. But, even here, if the servant had an appreciative knowledge of the danger, he was held to have assumed the risk. I shall attempt to show

[3]"In all actions for personal injury to an employee and in all actions where such injury results in death, such employee shall not be held to have assumed the risk of his employment in any case where such injury or death results in whole or in part from the negligence of the master; except as to conductors, or locomotive engineers, in charge of dangerous or unsafe cars or engines voluntarily operated by them."

[4]Wilbe Lbr. Co. v. Calhoun, 163 Miss. 80, 140 So. 680 (1932); Gow v. Hunter, 175 Miss. 896, 168 So. 264 (1936).

[5]Y. & M. V. R. R. v. Hullum, 119 Miss. 229, 80 So. 645 (1919).

later that under (II) it was negligence for the servant voluntarily to have assumed an obvious risk, provided such risk involved a danger which it was negligence for the master to create.

Now, there are two principles accepted as applying to assumption of risk. One is that the servant assumes all the risks (I); the other is that the servant never assumes the risk of the master's negligence.[6] It is apparent that under (II) the master has failed in his duty and is negligent. If, however, the servant knew and appreciated the danger and voluntarily encountered it, he could not recover. Here the servant's knowledge defeated him, but it is inconceivable that such knowledge was seen in any other light than an element of contributory negligence. The latter doctrine had been recognized for forty years before the former gained judicial sanction originally as a short-cut to the establishment of negligence. Knowledge of the defect soon attained the despotic dignity of a presumption. That it was still a theory allied to contributory negligence is seen in the fact that such presumption was—whether so identified or not—one of negligence.[7] The *rationale* of such doctrine was, consciously or unconsciously, borrowed from the doctrine of contributory negligence. While the logical basis for denying recovery under (II) was that the servant had failed in his duty to himself, it was generally but illogically bottomed upon an agreement inhering in the implied contract of employment. Since the master was excused from liability because of the servant's knowledge, the fact of the master's negligence was under-emphasized.

No defense is needed nor appropriate, except where otherwise there would be liability. Using the word "defect", here and hereinafter connoting an unusual and dangerous condition not ordinarily contemplated as appurtenant to a particular work, place or appliance, it is seen that whenever a servant is sought to be barred of recovery because of his knowledge of such defect, it means knowledge of the master's negligence.

It is no tribute to the logic of our early decisions that knowledge of the master's negligence barred the servant, rather than that negligence of the master made the master liable. So that, while the courts preserved the principle that the servant does not assume the risk of the master's negligence, he did often assume risks *when* the master was negligent.[8]

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[6]20 R. C. L. 12, 107.

[7]Compare the holding in Malcolm v. Fuller, 152 Mass. 160, 25 N. E. 83 (1890), where it was stated that "the servant assumes the risk of his own negligence."

[8]See note 6, *supra.*

Under (I), therefore, there is no negligence involved, and the expression "assumption of risk" was employed merely to explain why there was no actionable negligence. The risk assumed was of danger and not negligence. Under (II) there is negligence (and knowledge) by the master, which may (1) be unknown to the servant, or (2) known to him. If the servant was (a) guilty of careless conduct at the time of the injury, or (b) continued in the employment in the face of a danger which he appreciated, he was negligent. This assumes, of course, that in view of the imminence of injury he, as a reasonably prudent man, should have refused to expose himself. We are not at this time considering to what extent this view has been modified by later statutes or decisions in our own state.

The proper defense in both (a) and (b) above was contributory negligence. Of course, if the servant was injured solely by his own carelessness, it was not contributory negligence. If the servant did not know, or knowing, did not comprehend the risk created by the defect under (II), he was not negligent. Here the master was liable, because the risk of his negligence was never assumed by the servant.

Since knowledge is the key-word in all definitions of negligence, it should be the controlling factor in adjudging the conduct both of the master and of the servant.[9] This should lead logically and inevitably to the conclusion that if the creation of the defect by the master constitutes negligence, the voluntary exposure thereto is contributory negligence of the servant. From another viewpoint, if the place or appliance is so dangerous as to be obviously unsafe to an ordinary prudent servant, the master is negligent in so providing it. If, on the other hand, an ordinarily prudent servant would not continue to expose himself to the known danger, the place is not reasonably safe, and (if the master has not used reasonable care to make it so) the master is negligent. If under such circumstances the servant continues to work (expose himself) he, too, is negligent. Thus, his continued conscious *assumption of the risk* is *contributory negligence*, and should have been so denominated.

The risk of the ordinary dangers arising in the course of a reasonably prudent discharge of his usual duties are assumed by the servant. If the mental processes of the student are stimulated by viewing this situation as an assumption of risk, this privilege and satisfaction need not be gainsaid. But to preserve integrity as a legal doctrine it must be accepted that the servant as-

[9] *Ibid.*

sumes the risk of dangers but not of negligence. Under (I) the servant is conclusively presumed to know and accept the ordinary dangers belonging to his work. This is assumption of risk in its popular and legal sense. Under (II), if the danger is sufficiently grave and unusual to be deemed negligence of the master, the practical result is that the servant, voluntarily exposing himself, is negligent.

A plea of contributory negligence necessarily conceded some negligence on the master's part to which the plaintiff's negligence contributed. Thus is explained to some degree why encouragement was lent to the practice of casting the plea in the form of assumption of risk.

I should not discourage employment of the phrase by those who find in it a concise doctrine explaining that the master is not liable, but I am emboldened to reprobate the tendency, still rife, to use the phrase to explain that the master is not negligent. Under (I) the master is not negligent; but under (II) the master is always negligent. Else there would be no need for any defense.

Since, at common law, contributory negligence was a bar to recovery, there was no occasion to evaluate the master's negligence. The only propriety in the use of assumption of risk as a complete defense was upon the idea that it was intended to indicate the servant's contributory negligence.

Under (I) the servant was not negligent because the master was not; under (II) the servant was negligent because the master was.

It is realized that the view leads to the conclusion that whenever the master is negligent the servant would be.[10] I think this is true, for the servant is as negligent in voluntarily exposing himself to a known danger as the master was in creating it.[11] The servant owed a duty to himself as great as that owed by the master. In spite of the plausibility of this view, the complete bar afforded by contributory negligence prevented a comparison between the responsibility of the master and the servant, respectively, for the servant's safety.

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[10]Compare the language of Knowlton, J., in his dissenting opinion in Davis v. Forbes, 171 Mass. 170, 51 N. E. 20 (1898): "In such a case it would appear in the last analysis . . . . either that the plaintiff was negligent, or that the defendant was not negligent."

[11]It was a doctrine of the common law that the master was not under a duty to use more care for the protection of the servant than the servant for himself. Compare Priestley v. Fowler, 3 M. & W. 1 (Ex. 1837).

If the place was not so obviously dangerous that the servant, as a reasonably prudent man, would quit the work or avoid the task, it was deemed reasonably safe. The test was thus sought in the servant's conduct rather than in the master's duty. If more logically we reverse the reasoning and make the initial inquiry, (a) was the place reasonably safe, and, if not, (b) did the master use reasonable care to make it so, we lay the foundation properly on the master's conduct. This process makes clearer the injustice of a doctrine which used the servant's conduct to bar the servant, rather than the master's conduct to bind the master.

The master's freedom from liability was steadfastly referred to the conduct of the servant instead of his own. Thus, in an early case[12] expounding the doctrine of assumption of risk it was said:

> "The master may have neglected his duty as to those of his workmen who did not know of, or were not affected by, the particular defect, but not as to the plaintiff."

Illogical and unjust in its conception, it is logical that it should lead to illogical conclusions. For example, since the servant's knowledge was the controlling factor, it could be reasoned that the more glaring and dangerous the defect, the greater the servant's negligence. Later, I shall show that there is, of course, a logical relation between the degree of danger made obvious by a defect and the degree of care required of the servant.[13] The flaw in the above reasoning, however, is that the extent of the master's negligence was taken into account solely in appraising the servant's duty.

To summarize, it can be seen that assumption of risk is not, strictly speaking, a defense. If the master is not negligent, the risks being usual and ordinary, there is no occasion for any defense. If the master is negligent, then (1) if the servant knows of the defect and appreciates its potentialities and probability of injury and consciously exposes himself, he is guilty of contributory negligence; (2) if the servant did not know of the defect (and hence the danger) he was not contributorily negligent, and did not assume the risk of the master's negligence.

Knowledge, I repeat, is the necessary ingredient in the definition of negligence.[14] The injustice of stressing the plaintiff's

[12]Yarmouth v. France, L. R. 19 Q. B. D. 647 (1887).

[13]See later discussion of this point. Compare the language of Folger, J., in Laning v. R. R., 49 N. Y. 521 (1872), to the effect that a plaintiff's knowledge of the danger casts on him a higher degree of care and responsibility.

[14]A. & V. Ry. v. White, 106 Miss. 141, 63 So. 345 (1913).

knowledge to the obscuring of the master's knowledge was recognized in the adoption of Section 193 in the Constitution of 1890.[15]

Assumption of Risk and Contributory Negligence

The task of contrasting the doctrine of assumption of risk with the defense of contributory negligence has been assigned for students' essays throughout the years. Courts have repudiated and defended a distinction. Interesting as it may be as a theory, practical considerations make it difficult to distinguish them as legal defenses.

The labor with which refinements of meaning have sought to be made bespeaks some fallacy in the logic invoked to support a practical distinction.

The writer is aware that the most plausible distinction is based upon the contention that negligence of the servant is not seen as an issue under assumption of risk; that the servant's knowledge of the defect (master's negligence) is deemed to bar the servant without regard to the negligence *vel non* of the servant. Later, I expect to show that knowledge itself—so important a factor in negligence—is an element of the servant's conduct, and, in every injury, influenced or should have influenced the servant's conduct. I am aware also that the doctrine is sought to be differentiated as resting *ex contractu,* while contributory negligence arises *ex delicto.* The unsoundness of this artifice will be adverted to later. It is sufficient here to state that the defense of contributory negligence was first recognized and formally announced in 1798.[16] The doctrine of assumption of risk was probably first introduced in to the law of master and servant in 1837[17] while the theory of contract as its basis was probably first enunciated five years later.[18]

As late as 1898 it was declared in a thoughtful dissent in *Davis v. Forbes*:[19] "I hope that this fashionable modern doctrine will not lead to a departure from the sound principles on which the law of negligence rests."

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[15]"Knowledge by any employee injured of the defective or unsafe character or condition of any machinery, ways, or appliances, shall be no defense to an action for injury caused thereby . . . ." This language is also incorporated in MISS. CODE ANN. (1930) § 6154.

[16]Cruden v. Fentham, 2 Esp. 685, 170 Eng. Rep. 496 (N. P. 1799). Also in Clay v. Wood, 5 Esp. 44, 170 Eng. Rep. 732 (N. P. 1809). It is generally expressed that it was first formulated judicially in Butterfield v. Forrester, 11 East. 60, 103 Eng. Rep. 926 (K. B. 1809). See 20 R. C. L. 101.

[17]Priestley v. Fowler, 3 M. & W. 1 (Ex. 1837).

[18]Farwell v. B. & W. R. R., 45 Mass. 49 (1842).

[19]171 Mass. 548, 51 N. E. 20 (1898).

In our own state the legislative history of these doctrines is as follows: In 1890 the doctrine of assumption of risk was, in effect, abolished as to railroad employees by Section 193, and made statutory by Section 6154 of the present Code; in 1898[20] the legislature sought to abolish the doctrine as to all corporations, but the act was declared unconstitutional;[21] in 1910 the legislature abolished contributory negligence as a bar and introduced comparative negligence;[22] in 1914 the legislature abolished the doctrine of assumption of risk.[23] Although the phrase has been applied in actions against third parties,[24] it is today restricted generally to the relation of master and servant. Mississippi Code Section 513 recognizes this restriction.

The common law had always recognized the master's duty to use reasonable care for the servant's safety, and that the servant never assumed the risk of the master's negligence. Yet, the common law was individualistic in its tendency. The people in asserting their rights and liberties declared in effect that they were able to take care of themselves. Having so boldly asserted these rights they were inevitably confronted with the duty of maintaining them. A by-product of this tendency was a legal theory which, while it did not diminish the master's duty, considerably lightened his amenability for its breach.

Even at the outset the courts, although willing to bar the servant for knowingly assuming a risk of injury traceable to the master's negligence, were not ready to recede from the fundamental principle that the master owed to the servant the duty of using reasonable care to make the place (tools, *etc.*) reasonably safe.[25]

At a period when the desire to protect and encourage the industrial development permeated, albeit imperceptibly, the judicial chambers, a too lofty regard for the servant's responsibility as engendered. The decisions of the period prior to 1890 reflect the inevitable inconsistencies consequent upon the attempt to preserve the master's business as an economic necessity. Indeed, an emi-

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[20]Miss. Laws (1898) c. 66, § 1. See dictum in McDonald v. Wilmut Gas Co., 180 Miss. 350, 176 So. 395 (1937).

[21]Bradford Const. Co. v. Heflin, 88 Miss. 314, 42 So. 174 (1906).

[22]Miss. Code Ann. (1930) § 511.

[23]Miss. Code Ann. (1930) § 513. Later, I shall try to show that Section 513 was hardly a necessary expedient.

[24]Thomas v. Quartermaine, L. R. 18 Q. B. D. 685 (1887), and James v. Rapides Lbr. Co., 50 La. Ann. 717, 23 So. 469 (1898), are examples.

[25]The complete expression should include: "for a servant who, in turn, exercises reasonable care for his own safety." Compare City of Greenville v. Laury, 172 Miss. 118, 159 So. 123 (1935).

nent text writer[26] insists that the ultimate basis of the doctrine is economic and not juristic.

As further illustrative of the dilemma to be expected when even reason is sought, not to formulate a doctrine, but to sustain and conform to an artificial and predetermined concept, the courts were led generally to consider negligence cases from the standpoint of the servant's conduct rather than from that of the master. Even the servant's careful discharge of a dangerous duty was held a bar to recovery, where the servant was aware of the defect.[27]

That the employment was dangerous was not interpreted in terms of the master's failure to use due care, but of the servant's voluntary assumption of the risk. For the master to designate the servant's conduct as contributory negligence savored too much of an admission of some negligence by the master. To avoid classifying as negligence the mere working by a servant at a dangerous job under the urge of necessity, the servant was held to have suffered an injury which, because it involved no negligence of the master, was unfortunately "just too bad". To substitute euphemism for logic, the doctrine was christened "Assumption of Risk". Already embodied as an element in contributory negligence, it favored the master by allowing a defense which did not concede prima facie any initial negligence by the master. It lightened the master's burden of defense by making sufficient a showing merely of knowledge (of the defect) by the servant. Nothing short of negligence should have been a defense against negligence. It is not surprising that this new doctrine[28] should be separated by a rationale[29] which sought disavowal of any negligence to actions *ex delicto*.

If the danger was ordinary, or even if it was extraordinary, but known to the servant, he never reached first base. Three strikes were called on him by the law as he stood facing the master; one, he knew of the defect; two, he consented to the risk (*volenti non fit injuria*) ; three and out, he had "contracted" with reference to the risk and danger. Extending the homely figure, the only way the servant got on base was for the master to hit the batter with a recklessness tantamount to a technical "bean ball" while the servant was spitting on his hands.

All of the devices distracted attention from the important circumstance that the place or appliance was dangerously defective,

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[26]1 LABATT, MASTER & SERVANT (2d ed. 1913) §§ 62, 156.

[27]Later, I shall undertake to show that a careful exposure to an appreciated danger rarely results in injury.

[28]As shown above, it received judicial sanction nearly forty years after contributory negligence had been recognized.

[29]The theory of "contract". See discussion *infra*.

the master should have been liable because of his (actual or constructive) knowledge, rather than that the servant should be barred by his own knowledge.

These anomalies fostered attempts to distinguish assumption of risk and contributory negligence as defenses, whereas if the servant was barred it was because he was in effect held guilty of negligence in working in a situation which was dangerous enough to constitute negligence by the master.

There was no difficulty in exonerating the master when he was not negligent (had used due care). Injury under these circumstances was simply an accident, the risk of which was assumed by the servant. Nor was there any difficulty where the servant's own conduct was the sole cause of the injury. Thus far, contributory negligence is not involved, for there is no negligence of the master to which the servant's negligence could contribute. But when there was an extraordinary (and hence not inherent) danger known to both master and servant, contributory negligence being a complete bar, the courts scrutinized first the servant's conduct. If he could be charged with that essential ingredient of negligence —knowledge—there was deemed no need to go into the question of the master's negligence.

"Assumption of risk" was an effective and convenient phrase with which the master could designate the servant's responsibility. So that the phrase, instead of explaining merely why the master's negligence did not carry liability, came to be used as a defense against liability. As contended *supra*, by voluntarily assuming (exposing himsef to) a known danger, the servant was, in fact, negligent, even as was the master in creating the danger. The defense should have been contributory negligence.

Originally contributory negligence defeated recovery, not on the theory that one wrong offset the other, but because of the difficulty of measuring and comparing negligence. There was also involved a fear that the plaintiff might be allowed damages for his own wrong.[30] It is strange that such a doctrine as assumption of risk would develop when it would have been more reasonable and just that the master assume the risk of the servant's injury due to the master's negligence.[31] It was reasonable that the servant's negligence be given play, but when used as a bar, the master's negligence was ignored.

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[30]Heil v. Glanding, 42 Pa. St. 493, 499 (1862); 1 THOMPSON, NEGLIGENCE (1901) § 168.

[31]"Until conditions are made safe, the master is to assume the risk." 2 RESTATEMENT, AGENCY (1933) § 522.

Since contributory negligence was already a bar, it would seem to have been necessary to invent another doctrine, referable to the servant's conduct. Although it was illogical to defeat the servant with a defense different in rationale from that which fixed liability on the master, the necessity for isolating assumption of risk from the bases supporting contributory negligence led to many inconsistencies. It was sought to be supported on the doctrines of waiver,[32] of estoppel,[33] contract,[34] public policy,[35] and tort-feasors. In 1848 it was held that the theory of "contract" was read into the relationship not so much as an incident thereto but upon the ground of public policy, because "the absence of a remedy made the servant more careful". This fairly represents the confusion inevitable in attempting to place the liability for and the defense against negligence on bases other than the only one appropriate—reciprocal duties.

It seems astonishing that this stowaway in the employer's already seaworthy life-boat should, upon disclosure and identification, have passed through successive stages of castigation and toleration into ultimate command of the crew. In the early cases assumption of risk merely explained why the master was not negligent; contributory negligence, why the master was not liable. The former explained why no defense was needed; the latter was the defense. Many courts attributed the servant's "inability to sue" to a waiver of such right, without due appreciation of the controlling fact that, since the master was not negligent, the servant had no such right.[36]

Although many courts have insisted upon maintaining a distinction between the two doctrines as defenses it is interesting to find that the best reasoned cases concede that when the defense is placed upon the fact that the servant continued in a dangerous employment fully aware of its dangers, the two doctrines become merged. Both are phrased from the lexicon of negligence.

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[32]1 THOMPSON, NEGLIGENCE (1901) § 184; Crown v. Orr, 140 N. Y. 450, 35 N. E. 648 (1893).

[33]BEACH, CONTRIBUTORY NEGLIGENCE (3rd ed. 1899) § 16; Busch v. Robinson, 46 Ore. 39, 81 Pac. 237 (1905).

[34]This will be discussed later herein. To make the servant his own insurer seems appropriate only to an unenlightened age. Yet, there are cases upholding the view that the servant, as part of the consideration for furnishing him a job, waives any claim for damages. It is interesting to speculate why the courts waited so long to recognize that the master, as part of the consideration for the services furnished by the servant, "agreed" to keep the place reasonably safe.

[35]Compare Middleton v. Nat'l. Box Co., 38 F. (2d) 89 (S. D. Miss. 1930).

[36]See, as typical of the theory of such waiver, Mahoney v. Dore, 155 Mass. 513, 30 N. E. 366 (1892).

In the *Restatement of Agency*, Section 525(b), it is practically conceded that the doctrines are the same. Labatt[37] suggests the abolition of assumption of risk.

The doctrine should have been restricted to an explanation as to why the master is not held negligent. It was found impossible to define it except in terms of due care and negligence. It is but a phase of contributory negligence, utilizing its nomenclature and combatting the same basis of liability-negligence.

In an interesting dissenting opinion in the leading case of *St. Louis Cordage Co. v. Miller*,[38] Judge Thayer said:

> "I do not regard the question whether contributory negligence and assumption of risk, considered as defenses to an action for personal injuries are identical or are different defenses, as of much importance. That is rather a question for schoolmen."[39]

It is acknowledged that there are some factors peculiar to the relation of master and servant. For example, there is no duty upon the servant to inspect in order to make the place of work safe. The servant is indeed required to observe what is reasonably apparent, but not to inspect.[40] But once the servant gains knowledge of a defect or danger it becomes immaterial how such knowledge was obtained. Any duty of the master to disclose, instruct or warn is thereby fulfilled or dispensed with. Such knowledge, therefore, becomes a gauge to the servant's subsequent conduct.

It is true that it is the master's non-delegable duty to use reasonable care to make the place of work reasonably safe. The servant has the right to presume that the place is reasonably safe. But such presumption, like others, must yield to facts. The master must use reasonable care not to injure the servant; the servant must use reasonable care to avoid injury. This is a duty owed both to himself and to the master.

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[37] 1 LABATT, MASTER AND SERVANT (2d ed. 1913) §§ 62, 156. The same writer in a note (1900) 49 L. R. A. 62, says: "There are doubtless cogent reasons of abstract justice and public policy in favor of . . . . the doctrine that the servant should be barred only by contributory negligence, and that this should not, except in the clearest cases, be inferred as a matter of law from the mere knowledge of the dangerous conditions."

[38] 126 Fed. 495 (C. C. A. 8th, 1903).

[39] It is of interest that Judge Thayer wrote the majority opinion in Southern Pac. Co. v. Yeargin, 109 Fed. 436 (C. C. A. 8th, 1901). It was there said: "Whether he (the servant) acted with ordinary prudence in remaining in the defendant's service, with the knowledge which he had acquired of the insufficient equipment . . . . is the true test by which to determine whether he assumed the particular risk." It is apparent that he thereby limits the assumed risks to such as would have constituted contributory negligence.

[40] 39 C. J. 725, § 932.

As previously stated, the master has the primary duty as to the safety of the place of work and a continuing non-delegable duty of inspection and maintenance. He is charged with such knowledge of conditions as reasonable care would disclose. The servant is charged with none of these duties. But once knowledge of a defect (danger) is common to both, the duties created thereby are likewise common to both. There is no reason to apply two separate standards of conduct. To reiterate, it would be unreasonable to say that a place is reasonably safe to work in, and at the same time that it was not reasonably safe to hire another to work therein. Why should it be easier to say that the master cannot delegate to the servant his (the master's) duty to use reasonable care, than to say that the servant, with full appreciation of the danger, cannot delegate to the master his (the servant's) duty to use reasonable care?

Summarizing these contentions, it is submitted that: When a defect creates a danger sufficiently unusual, grave and imminent and evidenced by a failure of the master to use reasonable care (negligence), the voluntary exposure to such danger by a servant who appreciates its possibilities is negligence. If there are those who are addicted to the use of the phrase "assumption of risk", let them integrate it with contributory negligence by recognizing that in the submission just made it would be *negligence* for the servant to *assume such risk.* Such was, in effect, implied in *Bunt v. Sierra Butte, etc., Co.*,[41] where it was held that the evidence would warrant no other conclusion than that he (the servant) *took the risks* of the work, and that his *negligence* was the direct cause of his death. Also, in South Carolina[42] it was held that by continuing to work with knowledge of defects the servant assumed the risks and thereby contributed to the injury by his negligence. In New York it has been held[43] that "the deceased knew all about the facts and voluntarily *assumed* the risks, and thus, by his *contributory negligence,* precluded recovery. (Italics supplied).

The Contract Theory of Assumption of Risk

The contract theory of assumption of risk was manifestly a device whereby the doctrine might be lent plausibility as being distinct from contributory negligence.

The servant "contracted" to assume the risks which, under (I), he was presumed to know and which, under (II), he had knowledge. Thus, knowledge was viewed as the keystone in the

[41]138 U. S. 483 (1891).
[42]Donahue v. Enterprise R. R., 32 S. C. 299, 12 S. E. 560 (1890).
[43]Cullen v. Norton, 4 N. Y. Supp. 774 (1889).

arch upholding the master's immunity; whereas, it should always have been recognized as the diagnostic mark of negligent conduct.[44]

The following expressions are typical and comprehensive enough to dispense with further consideration of this topic:

> "It does not follow that whenever a duty is cast upon a person, the law will imply a contract on his part to perform it;"[45] also
>
> "Liability does not arise from contract[46] but springs from a breach of that duty which each member of the community owes to each other member."[47]

The Servant's Duty and Responsibility

Formerly, the servant's conduct was too much stressed because the master's immunity was thereby determined. Later, the master's negligence came to be over-emphasized, thereby obscuring the servant's responsibility. The fact or suspicion of liability insurance in many cases operates to take emphasis from the servant's negligence, even though the controlling legal principles are properly submitted through instructions to the jury.

There must be kept in mind the distinction between extraordinary dangers and work that is extraordinarily dangerous. The former implies different degrees of danger within a particular employment; the latter a comparison between different forms or methods of employment. As to the latter no negligence is implied.

It has been broadly stated that[48] the duty owed to a servant is comparable to that owed an invitee. It is interesting to consider the duty owed to an invitee, since here any responsibilities peculiar to the master-servant relation can be eliminated as complicating factors. Let us consider a case where *A* and *B* are engaged in

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[44]The late Justice Holmes referred to the "notion of contract" as "rather shadowy". Schlemmer v. Buffalo, *etc.*, R. R., 205 U. S. 1 (1907).

[45]Wilde, J., in Riley v. Baxendale, 6 H. & N. 445, 158 Eng. Rep. 183 (Ex. 1861).

[46]It was held in D. & R. C. Ry. v. Norgate, 141 Fed. 247 (C. C. A. 8th, 1905), that it was a false doctrine that assumption of risk is created by contract. The court said: "It is independent of the will of either. It is not a term of the contract of employment . . . . It is a principle of the common law."

[47]Cooper, J., in L., N. O. & T. Ry. v. Conroy, 63 Miss. 562 (1886). The most plausible exception arises in cases where the servant is actually *induced* to undertake a particular task, either by the master's assurance of safety or his promise to repair or remove the alleged danger. See Pearl R. V. Ry. v. Moody, 178 Miss. 1, 171 So. 769 (1937). If compelled by threat, see Gulf & S. I. Ry. v. Bryant, 147 Miss. 421, 111 So. 451 (1927). Here "*volenti fit injuria*" would embody the rationale.

[48]Bigelow, Torts (7th ed. 1901) 328; Story, Agency (9th ed. 1882) 453(d).

tasks near an unguarded revolving saw operated by *C*, the presence and dangers of which both know. If both carelessly come in contact with the saw and are injured there would seem to be no reason why their rights and responsibilities should not be the same. Suppose that *A* was employed by *D* and was delivering ice to *C* and was washing same off on a platform a few feet away from the saw. His knowledge of the saw and its dangers would bar his recovery against *C*.[49] What are the rights of *B*, the servant *C*? Has his conduct been more or less prudent than that of *A*? If *A's* conduct was negligent enough to be the cause of his injury, would not *B's* conduct (but for Section 513 of the Mississippi Code) bar him also?

Let it be supposed that a standard and accepted piece of machinery properly inspected and apparently sound suddenly becomes defective. A servant aware of the danger thereupon, without due regard for his safety, exposes himself. It would be usual to say the master was not liable because he was not negligent. But this does not emphasize the fact that from the servant's viewpoint he (the servant) was one hundred per cent negligent. Now, suppose that there had been an interval charging the master with knowledge of the defect; the servant would be no less negligent. There was negligence on the part of the master sufficient to make him liable thereon.

In 1892, on this side of the Atlantic it was held in a leading case[50] that the jury "should not be permitted to consider the conduct of the defendant by itself and find that it was negligent, and then consider the plaintiff's conduct by itself and find that it was reasonably careful." Yet, it is deferentially suggested that this is exactly what ought to be done. Procedural routine unfolds the case in just this manner. If there is no negligence of the master, there is no case and no need of a defense. This defense must relate to the conduct of the servant.

Emphasis on this point is often lacking in master-servant cases because of the dis-inclination to avail of our comparative negligence statute.[51]

A citation from our own court[52] states a not inconsistent view: "One must use due diligence or ordinary care to avoid injury from

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[49]Such are the facts and the law disclosed in Wilbourn v. Charleston Cooperage Co., 127 Miss. 290, 90 So. 9 (1901).

[50]Fitzgerald v. Conn. R. Paper Co., 155 Mass. 155, 29 N. E. 464 (1891).

[51]For example see Sea Food Co. v. Alves, 117 Miss. 1, 77 So. 857 (1917), where the servant was injured by falling into a hole of which he was aware. Here was involved, however, the principle of temporary forgetfulness.

[52]V. & M. Ry. v. McGowan, 62 Miss. 682, 695 (1885).

another, failing in which he may not recover for what by diligence or care he might have avoided."

We need not pursue these analogies further. It may suffice to say that the time has come when we should recognize a middle ground between the two extremes where (a) the servant knows of the danger but does nothing with respect thereto to make it productive of injury, and (b) the servant knows of the danger but does nothing to avoid injury therefrom.

Section 193, Constitution of 1890[53]

It was proper that knowledge should be preserved as an indispensable factor in negligence. The doctrine of assumption of risk, however, placed such emphasis upon the servant's knowledge that, in time, proof of such knowledge (of unsafety) was all the master had to show to defeat the servant's claim.[54] While such knowledge was almost invariably and necessarily availed of insufficiently by the servant, no more injustice was done the servant by the doctrine than by the defense of contributory negligence. Yet, proof of the servant's knowledge was usually sufficient. It increased the plaintiff's burden by lessening that of the defendant.[55]

This Section did not take away the defense of contributory negligence nor "free employees from the exercise of ordinary prudence."[56] It was sought to abolish phase (II) of the doctrine of assumption of risk. While I have endeavored to show that for all practical purposes this was contributory negligence, the accent placed on mere knowledge of a defect had come to include even cases where it was assumed that the servant had, notwithstanding his knowledge, acted as a reasonably prudent person.

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[53]The language of this Section is incorporated in MISS. CODE ANN. (1930) § 6154: "Knowledge by an employee of the defective or unsafe character or condition of any machinery, ways, or appliances, shall be no defense to an action for injury caused thereby . . . ." (except as to conductors, engineers, *etc.*)

[54]The doctrine was originally employed by the master as interpreter for contributory negligence. Having displayed growing proficiency in its vocabulary and marked efficiency in handling dangerous situations, it was soon promoted by the master to the position of chief bodyguard.

[55]It is not an affectation to suggest that the adaptation "*scientia ipsa loquitur*" would supply not an inappropriate maxim. So the maxim of substantive law "*volenti non fit injuria*" could be read "*scienti*" without losing propriety. Compare Sea Food Co. v. Alves, 117 Miss. 1, 77 So. 857 (1917), where the maxim held inapplicable because plaintiff did not "willingly" suffer his injury. This test may be considered too liberal. Reference is also suggested to Smith v. Baker, L. R. (1891) A. C. 325, which says: "A person is never *volens* that he should be injured by negligence . . . . The maxim applies where, knowing the danger, the man is willing to undertake the work."

[56]Buckner v. R. & D. Ry., 72 Miss. 873, 18 So. 449 (1895).

It must be conceded there may be an exposure to a known risk that would not be imprudent.[57] Under phase (I) the servant could assume ordinary hazards without being held negligent. Likewise, his duty to use "Requisite Care" in the face of known extraordinary dangers was not a guarantee against injury. It is not imprudent for the servant to take some risk. Nor is it negligence in the master to permit some danger to exist.

Negligence should not, of course, be adjudged by legal presumption against the servant who, aware of danger, is injured thereby. Yet, practically considered, a servant rarely suffers injury from an obvious danger when he has used reasonable care to avoid it. No one could afford to suggest the doctrine of *res ipsa loquitur* here.[58] It is a doctrine sanctioned by law in some cases. Yet, it is a fact sanctioned by human experience that reasonable care and prudence should, and almost always does, eliminate such injuries as are not "accidents" properly so-called. It is not amiss to suggest that it is practically impossible for two forces represented by automobiles to collide at an intersection without negligence of at least one of the parties. The maxim would be too harsh here, but the common experience behind such negligence cases is not unlike that which became crystallized as a rule of evidence in the maxim. There are certain things that do not ordinarily happen except as the proximate result of a failure to exercise reasonable care. It is rare that an obvious danger is not avoidable by ordinary prudence. On the other hand, there are some dangers that can not be safely encountered with the highest care. One could hardly exercise any degree of prudence in drinking carbolic acid.

In cases from our own court, it will be found that Section 193 has been construed as affecting not the doctrine of assumption of risk, but the defense of contributory negligence. Yet, it was phase (II) of the doctrine of assumption of risk at which Section 193 was aimed. This phase had come to make proof of knowledge of the defect, *etc.* (not solely appreciation of the danger) a complete defense. Although not so analyzed by courts which saw in the doctrine a constriction of the defense of contributory negligence, it may be seen as a doctrine making such knowledge presumptively negligent.[59]

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[57]See notes 63, 64, *infra.*

[58]See note 54, *supra.*

[59]It was usual to describe the effect of Section 193 as destroying the rule that knowledge is "a bar to recovery"; *cf.* Buckner v. R. & D. Ry., 72 Miss. 873, 18 So. 449 (1895). It would seem more compatible with the rationale of the doctrine to say that Section 193 destroyed the legal inferences of *negligence* theretofore raised by the servant's *knowledge.*

For example, the Texas court[60] thus expressed it: "If a prudent man under the exigencies of the case would have taken the chance and acted as plaintiff acted, he is acquitted of negligence" (thus, as is usually the case, defining assumption of risk in terms of negligence). Continuing, the court held, ". . . . if he assumed the risk the question of contributory negligence does not arise for by his assumption of the risk he absolutely precludes himself from every injury resulting from the risk." In other words, the plaintiff was guilty of contributory negligence, but the defendant needed to prove only one factor in his negligence—his knowledge of the danger.[61]

A place may, despite the exercise of reasonable care, possess dangers. A servant may risk such dangers with reasonable care. Reasonable care (of master) does not guarantee absolute safety; reasonable care (of servant) does not guarantee security.[62]

Hence, a fixed rule or maxim would not be just. It must be based upon human fallibility and imperfection and not upon the standard of ordinary prudence and care. While knowledge is an important factor in negligence, it imports no negligence apart from the conduct of its possessor.

As stated above, one who is injured while engaged in his own affairs is not deemed negligent because he violates no duty to another. So, one who essays to jump a creek or to negotiate Niagra by tight-rope is said to take (or assume) his chances (risk). Yet, gauged as a mental quality, his willingness to expose himself to a known danger has all the qualities of negligence.[63] Where such voluntary exposure is to a danger created by his master he was precluded from recovery under the maxim *volenti non fit injuria.* Here the key-word is *volens*, which implied not only knowledge (*sciens*), but conduct notwithstanding knowledge. This is negligence.[64] So that when Section 193 was adopted it was sought to

[60]St. Louis & S. F. R. R. v. Mathis, 101 Tex. 342, 107 S. W. 530 (1908).

[61]See note 37, *supra.* Also, Meridian Grain, *etc.*, Co. v. Jones, 176 Miss. 764, 169 So. 771 (1936), where it was pointed out that: "If the place is not reasonably safe, still there is no liability on the part of the master if he had used reasonable care to make it reasonably safe."

[62]See note 63, *infra.*

[63]It is trite to remind the student that normal life involves many unavoidable risks. So one assumes the risk of sea-sickness, influenza, or infatuation, under conditions favorable thereunto. A place can be reasonably safe and yet retain risks. Necessarily, therefore, a servant can exercise reasonable care and yet sustain injury. This is phase (I) of assumption of risk.

[64]It is well to repeat that negligence of the master arises when his failure to use reasonable care results in a danger that is not ordinary (reasonably safe). But reasonable care does not insure against risks, nor, on the other hand, against injury. It is only where the master is negligent that the servant's conduct (as a defense) need be considered. The servant's exposure

abolish not contributory negligence, which involved knowledge and conduct, but to require the defendant to show more than mere knowledge. It should not be held to have affected the right to show, and the method of showing, that such conduct was negligent (*i.e.* showed, in view of such knowledge, a want of reasonable care or prudence).

In the early cases construing this section, the fact of the servant's knowledge (of a defect) was given a strained construction. Designed to eliminate the defense of assumption of risk (phase II), it was at first construed to defeat the master's defense of contributory negligence. A proper construction was reached in the case of *R. R. v. Scott*,[65] when the court said contributory negligence was "yet a defense as it was before but is not to be made out against an employee by the mere fact of his knowledge." The other cases are subjoined in the note.[66]

Section 511, Mississippi Code of 1930[67]

This statute, passed in 1910,[68] abolished the complete bar of contributory negligence and made effective comparative negligence. As heretofore stated, the doctrine of assumption of risk and the defense of contributory negligence operated to obscure the defendant's primary negligence. Comment has already been made as to the theories under which the bar was made effective.[69] The slightest negligence of the plaintiff was sufficient, even knowledge of the defect, upon the theory that it was necessarily made effective by some act, imported negligence[70] and was sufficient under phase (II) of the doctrine of assumption of risk.

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to ordinary risks is not negligence, else his employment would be *per se* negligent. He merely assumes these along with his duties. But when the dangers are extraordinary (master's negligence) the servant's voluntary exposure thereto was designated as "assumption of risk", phase (II). Since such conduct by a third person would be deemed contributory negligence, there is no reason to characterize the servant's conduct otherwise.

[65]95 Miss. 43, 48 So. 239 (1909).

[66]The Welch case, 70 Miss. 20, 11 So. 423 (1892); the White case, 42 Miss. 12, 16 So. 248 (1894); the Buckner case, 72 Miss. 873, 18 So. 449 (1895); the Daniels case, 73 Miss. 258, 19 So. 830 (1895); the Guess case, 74 Miss. 170, 21 So. 50 (1896); the Parker case, 88 Miss. 193, 40 So. 746 (1906); the Carroll case, 103 Miss. 830, 60 So. 1013 (1912); the Dana case, 110 Miss. 666, 70 So. 828 (1915).

[67]"In all actions hereafter brought for personal injuries . . . . the fact that the person injured . . . . may have been guilty of contributory negligence shall not bar recovery but damages shall be diminished by the jury in proportion to the amount of negligence attributable to the person injured . . . ."

[68]It was later amended by Miss. Laws (1920) c. 312.

[69]The master's negligence "was relieved"; "was insulated"; "was waived"; "was as if it had never happened"; "vanished"; *etc.*

[70]See note 55, *supra.*

It was originally felt that knowledge *per se* was sufficient to bar, but it was stressed as a controlling phase of contributory negligence. The defense was: I was negligent, but you knew of the defect and in spite of your knowledge you exposed yourself to injury. *Volenti* (*scienti*) *non fit injuria.*[71]

So, our own courts spoke often of knowledge as a bar, whereas, more precisely, such knowledge sufficiently indicated contributory negligence as to make available such defense. It was, therefore, at least consistent that Section 193 should be directed toward this ready device for invoking an already harsh doctrine. Section 511, Mississippi Code of 1930, abolished the bar of contributory negligence, however defined or proved.

Section 513, Mississippi Code of 1930[72]

This section sought to abolish "assumption of risk" as a complete bar in cases of master and servant (with the exceptions noted). While Section 193 of the Constitution abolished knowledge (of defect or unsafety) as a defense, it left conduct (with knowledge) as a determinative factor.[73] Section 511 abolished the doctrine, bag (knowledge) and baggage (conduct), since it abolished contributory negligence. This left little for Section 513 to accomplish. In fact, it is submitted that, as stated early in this discussion, it was from a practical standpoint unnecessary. There is no question that as to railroad employees it was supererogatory. As to other employees, it could not be expected to do more than abolish whatever remained after Sections 193 and 511 had been made effective.

Instead of abolishing the doctrine of assumption of risk by destroying one of its necessary phases, it abolished the doctrine *es nomine* in all cases where the master is negligent "in whole or in part".

First of all phase (I) of the doctrine implies no negligence either of the master or the servant, so that it would seem that Section 513 applies only to cases where the master is negligent (phase II). It is only in such event that the plaintiff would ever

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[71]See notes 55, *supra*, and 73, *infra*.

[72]Miss. Laws (1910) c. 135.

[73]Since the doctrine was usually invoked by showing the servant's knowledge, the phrase "assumption of risk" was generally seen as indicating passivity. However, as a practical concept one assumes a risk by some act or conduct (active or passive). Knowledge is appreciation of the mind; it furnishes the background upon which conduct is viewed. The injury is always the result of bringing (or keeping) the body in contact with the danger.

have the right to sue. There was never any occasion for the master to plead assumption of risk except as a defense to this negligence.

Also, why "in whole or in part"? Certainly if the injury was caused "in whole" by the master there would always be liability, for there would be no defense. Moreover if caused "in part" by the negligence of the master, it was caused "in part" by the contributory negligence of the servant. As heretofore shown, even under the narrowest conception of assumption of risk, mere knowledge never barred the servant, for unaided it never produced injury.[74]

These comments may, however, be of only academic interest. Let us suppose the legislature had chosen the shorter way and abolished the doctrine of assumption of risk. If the premise sought to be established above is sound, Section 511, by abolishing contributory negligence as a bar and giving play to the conduct both of the master and of the servant, preempted any advantage sought by Section 513. Even the strictest sect of devotees to the doctrine of assumption of risk would concede that no case remained unprovided for except where there is an extraordinary danger (master's negligence) to which a servant, fully aware of the risk, "carefully exposes" himself. Under Section 193 railroad employees were not barred by mere knowledge. An academic scrutiny of Section 513 would reveal that this immunity was extended to all employees. But, in view of Section 511, such advantage was theoretical.[75]

It is respectfully submitted therefore that, from a practical viewpoint, Sections 193 and 511 had given recognition to such conduct of the servant as had theretofore constituted a bar under either doctrine. They likewise gave full play to the master's negligence which theretofore had been too readily neutralized by that of the servant.[76]

Summary

I. Assumption of risk, even though acceptable as a doctrine, is not a distinct defense.

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[74]See note 73, *supra*.

[75]Additional practical considerations suggest reference to Section 512, where all questions of negligence and contributory negligence are for the jury.

[76]It is hoped this view is not in conflict with the intended meaning expressed in the dissenting opinion of our court in Hercules Powder Co. v. Tyrone, 155 Miss. 75, 124 So. 74 (1929), where it was said: ". . . . the comparative knowledge doctrine and Section 513 can not stand together." It is submitted that the Section (together with Section 511) gave full play to the servant's knowledge as a negligence factor, whereas prior thereto, where the servant's knowledge was equal to that of the master, he was barred. Yazoo City Transp. Co. v. Smith, 78 Miss. 140, 28 So. 807 (1900).

1. When the master is not negligent, no defense being required, it merely explains why the master is not negligent.

2. When the master is negligent, the phrase if employed, merely explains why the servant also is negligent.

II. The doctrine, if based upon implied contract, is artificial and gratuitous. The defense against negligence is negligence.

III. For all practical purposes assumption of risk and contributory negligence are not distinct.

1. Assumption of risk, being injected into negligence cases after contributory negligence had been established, was in effect a doctrine affecting (a) the issue of proximate cause and (b) authorizing an inference of negligence from the fact of the servant's knowledge.

2. So viewed, the doctrines can be separately stated and identified, but both deal with and interpose the negligence of the servant as a defense.

IV. Section 513 of the Mississippi Code of 1930, from the viewpoint of the adherents to the theory of separate defenses, served to remove whatever was left after Section 193 of the Constitution and Section 511 of the Mississippi Code of 1930, as still comprehended in the phrase "assumption of risk". From a practical viewpoint it is of no additional advantage to the servant. Section 513 did not abolish assumption of risk as a mental trait or as a fact; it merely abolished as a legal *defense* the fact of the servant's knowledge (of defects) as *per se* negligence.[77]

[77]This is true since, as soon as conduct is added to knowledge, there is contributory negligence. In practically all cases involving assumption of risk so called, our court has dismissed the defendants' contention (where recovery is allowed) with the simple explanation that "assumption of risk has been abolished." The defense of contributory negligence is raised in comparatively few cases.

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STATE BAR SECTION

BAR COMMENTS

The Mississippi Alien Statute

*Will E. Ward**

Like many other states,[1] Mississippi has enacted a statute relative to acquisition and holding of property by aliens. Section 2121 of the Mississippi Code of 1930,[2] which embodies this subject, reads as follows:

> "Resident aliens may acquire and hold lands, and may dispose of it and transmit it by descent, as citizens of the state may; but non-resident aliens shall not hereafter acquire or hold land, but a non-resident alien may have or take a lien on land to secure a debt and at any sale thereof to enforce payment of the debt, may purchase the same, and thereafter hold it, not longer than twenty years, with full power during said time to sell the same in fee to a citizen; or he may retain it by becoming a citizen within that time. All land held or acquired contrary to this section shall escheat to the state; but a title to real estate in the name of a citizen of the United States, or a person who has declared his intention of becoming a citizen, whether resident or non-resident, if he be a purchaser or holder, shall not be forfeited or escheated by reason of the alienage of any former owner or other person."

Very little litigation involving private rights has arisen under this statute. Hence, we must look to the decisions of other jurisdictions for an indication of its probable effect.

The leading case in this country dealing with the passing of title to non-resident aliens is *Fairfax v. Hunter*.[3] As to the passing of title to the alien and the circumstances under which such title could be attacked, the Court said:

> "It is clear by the common law, that an alien can take lands by purchase, though not by descent; or in other words, he cannot take by the act of law, but he may by

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[1]For a compilation of state statutes see *Alien Land Laws and Alien Rights* (1921) Doc. 89, 67th Cong., 1st sess.

[2]This section has been amended by Miss. Laws (1938) c. 354, which adds to the section as follows: "Provided, however, non-resident aliens are citizens of Syria, or of the Lebanese Republic, may inherit property from citizens or residents of the State of Mississippi." The constitutionality of this amendment is questionable in view of the Equal Protection clause of the 14th Amendment.

[3]7 Cranch 603 (U. S. 1813).

> the act of the party . . . . Nor is there any distinction whether the purchase be by grant or devise. In either case the estate vests in the alien, not for his own benefit, but for the benefit of the state; or in the language of the ancient law, the alien has capacity to take but not to hold lands, and they may be seized into the hands of the sovereign. But until the lands are seized, the alien has complete dominion over the same."[4]

And in the same case, as to the contention that the alien held title as trustee for the state, the court said:

> "It is incontrovertably settled upon the fullest authority that the title acquired by an alien by purchase is not divested until office found."[5]

Craig v. Radford,[6] *Governeur's Heirs v. Robertson*,[7] and *Billings v. Aspen Co.*[8] are other cases which follow this doctrine, and cite it with approval.

Where a party to a suit involving land interposes as a defense the alien party's illegal acquisition and holding of real estate, it has been uniformly held that this was a matter that could be raised only by the sovereign.[9]

It will be noted that Section 2121 does not render acquisition of land by a non-resident alien void *ab initio*. In fact, the last provision of the statute definitely negatives any such construction, especially in view of the general rule of statutory construction to the effect that an act prohibited by statute is not void unless made so by the statute.

From these and other authorities examined, it appears to be settled that both at common law and under statute, title to lands conferred upon non-resident aliens by deed or will can be attacked, if at all, only by the state;[10] that such attack would have to be in a direct proceeding in the nature of an inquest of office;[11] and that

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[4]7 Cranch 603, 619 (U. S. 1813).

[5]7 Cranch 603, 621 (U. S. 1813). In Cross v. DelValle, 1 Wall. 5 (U. S. 1863) it was held: "That an alien may take by deed or devise, and hold against anyone but the sovereign until office found, is a familiar principle of law, which requires no citation of authorities to establish." See Bailey, *Rights and Duties of Aliens within National Boundaries* (1927) 15 Ky. L. J. 196, 200.

[6]3 Wheat. 594 (U. S. 1818).

[7]11 Wheat. 332 (U. S. 1826).

[8]52 Fed. 250 (C. C. A. 8th, 1892). And see Taylor v. Benham, 5 How. 233 (U. S. 1847); 2 Am. Jur., Aliens, 476, § 29 and cases cited.

[9]Fairfax v. Hunter, 7 Cranch 603 (U. S. 1813); Craig v. Radford, 3 Wheat. 594 (U. S. 1818); Louisville Property Co. v. Nashville, 114 Tenn. 221, 84 S. W. 810 (1905); Abrams v. State, 45 Wash. 327, 88 Pac. 327 (1907).

[10]Donaldson v. State, 167 Ind. 553, 67 N. E. 1029 (1903); 3 Tiffany, Real Property (2d ed. 1920) 2350; Orfield, *Alien Land Rights in Nebraska* (1938) 17 Neb. L. Bull. 3; note (1930) 29 Mich. L. Rev. 101.

[11]Fairfax v. Hunter, 7 Cranch 603 (U. S. 1813); Cross v. DelValle, 1 Wall. 515 (U. S. 1863); Louisville Property Co. v. Nashville, Abrams v. State, both *supra* note 7.

no private party laying claim to such lands has any standing in court, either in a private suit or as a party to the inquest, to raise the question of alienage of the opposing party.

In the case of *Terrace v. Thompson*,[12] in which the constitutionality of state laws restricting the rights of aliens to hold land was attacked, the United States Supreme Court upheld a Washington statute which made possible any kind of legal or equitable ownership of land by aliens other than those who in good faith had declared their intention of becoming citizens. Thus, from a consideration of authorities,[13] it seems clear that a state may forbid both resident and non-resident aliens to hold real estate without violating the Federal Constitution. No rules of international law are violated by such provisions, assuming of course that there are no treaties protecting alien rights.[14]

The United States has negotiated a great number of commercial treaties with reference to rights of citizens and subjects of the contracting parties. The effect of such a treaty is to be viewed from two angles: (1) its supremacy over the laws of Mississippi and any public policy of the state expressed or inferred from the state's constitution and statutory provisions, and (2) the constructions to be placed upon the language of such treaties.

There can be no question as to the supremacy of a treaty insofar as it conflicts with the specific provisions of a state statute.[15] Article VI, Section 2 of the United States Constitution provides that the Constitution, laws and treaties of the United States shall be the "supreme law of the land". It is quite clear that the courts of this country, from *Ware v. Hylton*, in 1796,[16] down to *United*

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[12]263 U. S. 197 (1923). The legislation of this period is described by Chamberlain, *Legislation Affecting Aliens* (1922) 8 A. B. A. J. 305. In Toop v. Ulysses Land Co., 237 U. S. 580 (1915), in a memorandum opinion by White, C. J., the Supreme Court stated that a contention that the Nebraska law forbidding the ownership of real property by non-resident aliens was contrary to the 14th Amendment was too frivolous to support the jurisdiction of the Supreme Court of a direct writ of error to the federal district court of Nebraska. See also Powell, *Alien Land Cases in the United States Supreme Court* (1924) 12 CALIF. L. REV. 259.

[13]Terrace v. Thompson, 263 U. S. 197 (1923); Webb v. O'Brien, 263 U. S. 313 (1923); Porterfield v. Webb, 263 U. S. 225 (1923); Frick v. Webb, 263 U. S. 326 (1923); Cockrill v. California, 268 U. S. 258 (1925); Jordan v. Tashiro, 278 U. S. 123 (1928); Orfield, *The Citizenship Act of 1934* (1934) 2 UNIV. OF CHI. L. REV. 99.

[14]1 HYDE, INTERNATIONAL LAW (1922) § 203, p. 352; MOORE, DIGEST OF INTERNATIONAL LAW (1906) 33. See McClintock, *Aliens Under the Federal Laws of the United States* (1909) 3 ILL. L. REV. 501.

[15]Goos v. Brocks, 117 Neb. 750, 223 N. W. 13 (1929); Ware v. Hylton, 3 Dall. 119 (U. S. 1796); note, Ann. Cas. 1912A, 1100. The supremacy of treaties over conflicting laws was early established. Hence the problem in most cases has been whether the subject matter of the agreement was properly within the scope of the treaty-making power.

[16]3 Dall. 199 (U. S. 1796).

States v. Belmont,[17] in 1937, have uniformly upheld the supremacy of international compacts over state constitutions, laws and policies. We may therefore say with definite assurance that the Mississippi Alien Statute, as well as Section 84 of our Constitution of 1890 authorizing its enactment, insofar as it may conflict with any international compacts to which the United States is a party, must be considered as being completely abrogated.

Since the rights of aliens in regard to the ownership of property in this country depends largely on such treaties, it is fitting that we should make some mention of the principle applicable to their interpretation. Perhaps the leading case in this country respecting the construction of treaties is that of *DeGeofroy v. Riggs.*[18] In that case it was held that:

> "It is a general principle of construction with respect to treaties that they shall be liberally construed so as to carry out the apparent intention of the parties to secure equality and reciprocity between them. . . . And it has been held by this court that when a treaty admits of two constructions, one restrictive of rights that may be claimed under it and the other favorable to them, the latter is to be preferred."[19]

This same rule of construction was expressed earlier in the case of *Shanks v. Dupont,*[20] and has since been strictly adhered to.[21]

Only in extremely limited instances where persons die intestate, leaving property to persons residing in some country with which no commercial treaty exists—persons who would be heirs had they resided in this country—can the Mississippi Alien Statute prove fully effective, insofar as local claimants to the property are concerned. Any effort on the part of the state to excheat lands passing to non-resident aliens will, in virtually all cases, be halted by treaty relations. These observations are equally true, of course, as to all states having alien laws against ownership of property.

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[17]301 U. S. 324 (1937) (held that the public policy of a state was subject to the treaties of the United States). No state court has undertaken to deviate from these cases. See Wunderle v. Wunderle, 144 Ill. 40, 38 N. W. 135 (1888); Opel v. Shoup, 100 Iowa 424, 69 N. W. 563 (1896); Succession of Rabasse, 47 La. Ann. 1452, 17 So. 867 (1895); Trott v. State, 41 N. D. 614, 171 N. W. 827 (1919).

[18]133 U. S. 272 (1889). That such cases are explainable as an application of the well established doctrine that treaties are to be liberally construed is pointed out in (1937) 37 COL. L. REV. 1361, 1367, n. 39.

[19]133 U. S. 258, 271 (1890).

[20]3 Pet. 242 (U. S. 1830). And see Hauenstein v. Lyman, 100 U. S. 483 (1879).

[21]For state constructions see Adams v. Aukerland, 168 Ill. 638, 48 N. E. 457 (1897); Doehrel v. Hillmer, 102 Iowa 172, 71 N. W. 205 (1897); McKeown v. Brown, 167 Iowa 489, 149 N. W. 593 (1914); Erickson v. Carleon, 95 Neb. 182, 145 N. W. 352 (1914); Dockstader v. Roe, 4 Penn. (Del.) 400, 55 Atl. 341 (1903); *In re* Stixrud, 58 Wash. 353, 109 Pac. 349 (1910).

It would seem that two courses should be adopted, one by the states and the other by the Federal government, to clarify the status of property acquired in this country by aliens.

First: The states should leave to the Federal government the entire question of acquisition and ownership of property by aliens, placing this responsibility where it properly belongs.[22]

Second: The Federal government should adopt a uniform policy for negotiating treaties with friendly countries, and should particularly take steps to consummate such agreements in documents clearly and aptly drawn.[23]

Brief *Amicus Curiae* Filed on Behalf of the Mississippi State Bar in the Case of Liberty Mutual Insurance Co., *et al v.* Clark, *et al.**

The State Bar of Mississippi and your petitioner are interested in any matters which affect the public interest, the administration of justice and the welfare of the bar. For that reason this brief *amicus curiae* is filed to express to the court the interest and concern of *amicus curiae* in the success of the position taken by the Missouri Bar Administration in this case.

The problem which concerns this court is one which touches upon both the public interest and the maintenance of professional ethics. The problem of the unauthorized practice of law, as found in the activities of the lay adjuster has a definite relation to the maintenance of the ethics of the profession. It is both unfair and unwise to force the lawyer to refrain from solicitation for damage claims by force of disciplinary process and at the same time permit the employees of insurers to render legal advice to the claimant and his employer while soliciting the settlement of claims. The acts which are performed by the claim adjuster are those which are ordinarily performed by a lawyer in the giving of advice, preparation of legal documents and conduct of hearings. The public interest requires that those performing these services be possessed of skill and moral character to be determined on application for a license to practice. The public interest further requires that after securing a license, the licensee adhere to a moral code which places the public interest above private gain. To permit wholesale commercial engagement in the practice of law by corporate insurers will result in loss of the conditions which are now required of the practitioner in the public interest.

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[22]As pointed out in DeGeofroy v. Riggs, 133 U. S. 258 (1890).

[23]As suggested in Dockstader v. Roe, 4 Penn. (Del.) 400, 55 Atl. 341 (1903).

*Filed by R. M. Kelly, as President of the Mississippi State Bar, in the Supreme Court of Missouri. Reprinted by request of the State Bar Commission.

When it is admitted that a lay adjuster for the claimant is engaged in the practice of law and that his activities should be suppressed, it inevitably follows that the same treatment should be accorded to the adjuster for the insurer. It matters not for whom the acts are done; the sole concern is whether or not those acts constitute the practice of law. Not only is the maintenance of a licensed bar essential to the administration of justice and, therefore, required by the public interest, but the bar so maintained must be an *independent* bar. There cannot only be no independent bar but there can hardly be a bar at all if unauthorized practitioners are not properly dealt with by the courts.

It is useless to require a course of study and to require moral fitness to secure a license to practice law if those not possessed of the moral fitness and the learning are permitted to practice without a license.

The practice of law is considered a profession as distinguished from a business because of its idealistic code and place in the administration of justice. In a changing world which demands more of a professional attitude in business, more recognition of trustee and fiduciary obligations in the conduct of the business man, it would be a decided step backward, to turn over to the commercial world one of the two learned professions—a profession which is dedicated to public service—in order that the business man may traffic and make a commodity of that professional service.

If a corporation may conduct its own legal affairs through laymen, the end of the licensed bar is here. Certainly an individual has as much right as a corporation and it would follow that the individual may do likewise. There is then no place for a bar governed by prime obligations to the public interest.

Your petitioner respectfully submits to this court that the licensed bar should be maintained; that the public will be the loser if the practice of law is commercialized and thrown open to the general public, corporate and individual; therefore, the judgment of the lower court should be affirmed.

Respectfully submitted,

R. M. KELLY,
President of the State Bar of Mississippi.

NOTES

Saenger Theatre v. Hearndon—A Further Extension of Emotional Disturbance Theory

Recently a novel situation was presented to the Supreme Court of Mississippi, and recovery of damages was allowed for what appears to be pure mental suffering on the part of the plaintiff.[1] The defendant operated a moving picture theatre. Upon complaint from patrons that the plaintiff, a girl of fourteen years of age, and others, were guilty of boisterous and annoying conduct during the show, the defendant instructed the doorkeeper to exclude the plaintiff. Later the plaintiff, accompanied by her aunt, procured a ticket and presented herself for admission. The doorkeeper in excluding her from the show made the following statement: "That she could not enter; that she had been guilty of indecent conduct as rendered her an unfit and improper character to enter the show; and that she had been guilty of indecent and low-down conduct in the show." A verdict of $1000 was sustained on appeal. The court said that although recovery for mental pain and suffering is generally not allowed in the absence of physical injury, the rule will not apply in cases of "wanton and shamefully gross wrong".

This is apparently the first case where the Supreme Court of Mississippi has allowed recovery of damages against a corporation for emotional disturbance without any pretense of finding an independent tort or other wrong. The court assigns as its reason for the decision the fact that the mental pain was introduced by "wanton and shamefully gross wrong". However, upon examination of the cases it appears that even in cases of "wanton and gross wrong", the court has never before allowed damages without some attempt at finding an independent tort to which it attached the parasitical damages for emotional disturbance.

Mississippi undoubtedly still adheres, in form at least, to the old adage of no recovery without physical injury. This rule, however, has been so limited through exceptions that it no longer retains its former force and meaning. The following are some of the more commonly used exceptions.

If the plaintiff can show that the defendant committed an independent tort at the time of the alleged emotional disturbance, he may usually recover damages for mental suffering under the following circumstances. (1) If the plaintiff can find that the defendant committed a trespass to his real property, the court will usually attach damages for any mental suffering naturally following the trespass.[2] (2) Further, upon showing by the plaintiff that the defendant interfered with his personal property, he may often

[1]Saenger Theatre Corp. v. Hearndon, 180 Miss. 791, 178 So. 86 (1938).
[2]Indianola v. Woods, 118 Miss. 738, 80 So. 7 (1918).

attach damages for emotional disturbance.[3] (3) Damages for mental suffering are quite often allowed in the personal confinement cases.[4] (4) Or if a railroad or other public conveyance breaches an implied contract to stop at a certain place and take on passengers, then the plaintiff may include a count for damages for inconvenience.[5] (5) Where the defendant discharges the plaintiff from the train at the wrong place, the plaintiff may rightfully demand damages for mental suffering.[6] (6) Usually an invasion of the sanctity of the home merits an award of damages for emotional disturbance; this may be true although there is no actual trespass.[7] Or the invasion of any right of privacy may occasion such damages.[8] (7) An unreasonable delay in railroad service justifies a demand for a recovery of mental suffering.[9] (8) A criminal act, other than libel or slander, tending to degrade the character of some immediate member of the family may occasion a recovery of damages for mental suffering, provided the head of the family institutes the action.[10]

If the plaintiff shows that he received uncourteous treatment at the hands of a public utility, or that the public utility was grossly delinquent in the discharge of service to him, he may often recover for emotional disturbance occasioned thereby. Several groups of situations demonstrate this principle: (1) In death message cases the plaintiff may generally recover, although the injuries he suffers are purely mental.[11] (2) Or where insulting language is used by servants of the carrier, otherwise acting in their line of duty, damages may be allowed. This is often limited to language spoken to the plaintiff and will not include that which he may have overheard.

It appears that the present case represents a natural expansion of the above idea. Undoubtedly there is a modern trend toward imposing the same standard on all those who render services to the public *en masse*.

The present action could properly have been sustained under the Actionable Words Statute but for the fact that this Act has been held inapplicable where the defendant is a corporation.[12] Other states having similar statutes have reached a contrary conclusion.[13]

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[3]Fidelity & Guaranty Co. v. State, 121 Miss. 369, 83 So. 610 (1919).
[4]Hewlett v. George, 68 Miss. 703, 9 So. 885 (1891).
[5]Heirn v. M'Caughan, 32 Miss. 17 (1856); Wilson v. N. O. R. R., 63 Miss. 352 (1885).
[6]Bell v. Morrison, 27 Miss. 68 (1854); N. O., *etc.* R. R. v. Hurst, 36 Miss. 660 (1859).
[7]Continental Casualty Co. v. Garrett, 173 Miss. 676, 161 So. 753 (1935).
[8]Bonelli v. Bowen, 70 Miss. 142, 11 So. 791 (1892).
[9]Ill. Cent. R. R. v. Hawkins, 114 Miss. 110, 74 So. 775 (1917).
[10]Stone v. Bang, 153 Miss. 892, 122 So. 95 (1929).
[11]Western Union Tele. Co. v. Watson, 82 Miss. 101, 33 So. 76 (1903).
[12]Miss. Code Ann. (1930) § 11. See also Dixie Fire Ins. Co. v. Betty, 101 Miss. 880, 58 So. 705 (1912).
[13]Grant Co. v. Owens, 149 Va. 106, 141 S. E. 860 (1928).

Perhaps the apparent liberality of the Mississippi Supreme Court in extending common law protection of the emotions and sensibilities against corporate defendants is to be attributed in part to a growing appreciation by the court that its arbitrary exclusion of corporations from the terms of the Actionable Words Statute was a mistaken procedure.

John W. Whitten III

RECENT DECISIONS

BANKS AND BANKING—NEGLIGENT RETURN OF CHECKS TO PAYEES MARKED "INSUFFICIENT FUNDS"—BASIS OF RECOVERY AND NECESSITY OF ACTUAL DAMAGES.

Plaintiff, in the capacity of a depositor, and carrying on the business of a live stock trader, gave a check on his account with the defendant bank for eight dollars. This check was cashed by the bank for the payee; but the bank, due to its negligence in reading the marginal amount of the check, made an error of seventy-two dollars and charged his account with this amount. As a result several checks subsequently given by the plaintiff were returned to the payees marked "insufficient funds". Plaintiff, Weaver, sued for injury to his reputation and credit, and the trial judge granted a peremptory instruction in plaintiff's favor. The court instructed the jury to return compensatory damages, after having refused defendant's instruction for nominal damages only. The jury returned a verdict for plaintiff, assessing his damages "at nothing", which the court declined to accept. Thereafter a further verdict was returned for the sum of five dollars. Plaintiff appeals. HELD: The case is remanded with instruction that a new verdict for "substantial damages" be returned and that a verdict of five dollars is nominal damages only. *Weaver v. Grenada Bank*, 178 So. 105 (1938), *sugg. error overruled*, 180 Miss. 876, 179 So. 564 (1938).

The authorities in dealing with this question have reached three solutions. All agree that damages are not limited to the principal sum due plus interest thereon, and that under such proof as the courts may deem proper, substantial damages for injury to the reputation of plaintiff's credit may be recovered.

The majority view, and the view adopted by the present case, is to the effect that it is not incumbent on the injured party to prove special damage, but that such is to be presumed in the absence of circumstances to the contrary.[1] A few courts, including New York, adhere to the view that plaintiff must affirmatively establish damage to his reputation and credit.[2] Other states, which seem partial to the New York view, have gone so far as to enact statutes which regulate the damage which the plaintiff may recover in similar circumstances.[3] Still other jurisdictions adopt what might be termed a com-

[1]Atlanta Nat. Bank v. Davis, 96 Ga. 334, 23 S. E. 190 (1895); Hilton v. Jesup Banking Co., 128 Ga. 39, 57 S. E. 78 (1907); Shaffner v. Ehrman, 37 Ill. App. 34 (1890), *aff'd*, 139 Ill. 109, 28 N. E. 917 (1891); Wiley v. Bunker Hill Nat. Bank, 183 Mass. 495, 67 N. E. 655 (1903); Svendson v. State Bank of Duluth, 64 Minn. 40, 65 N. W. 1086 (1896); Pascagoula Nat. Bank v. Eberlien, 161 Miss. 337, 131 So. 812 (1931); Stevens v. Market Street Title & Trust Co., 65 Pa. Super. Ct. 288 (1916); Lorick v. Palmetto Bank & Trust Co., 74 S. C. 185, 54 S. E. 206 (1906). In Grenada Bank v. Lester, 126 Miss. 442, 89 So. 2 (1931) the court said: "There seems to be some conflict in authorities, but the modern and better rule appears to be that, where the bank wrongfully dishonors the check it is liable for substantial damages to the injured despositor as compensation. When the wrongful dishonor is shown, substantial damages are inferred because of the peculiar nature of the wrong; and it is for a jury to assess reasonable compensation to the injured party."

[2]Brooke v. Tradesmen's Nat. Bank, 69 Hun. 202, 23 N. Y. S. 802 (1893); Burroughs v. Tradesmen's Nat. Bank, 87 Hun. 6, 33 N. Y. S. 864 (1895), *aff'd*, 156 N. Y. 663, 50 N. E. 1115 (1898); Clark Co. v. Mt. Morris Bank, 85 App. Div. 362, 83 N. Y. S. 447 (1903), *aff'd*, 181 N. Y. 533, 73 N. E. 1133 (1905).

[3]ARK. DIG. STAT. (Pope, 1937) Banks & Banking, § 756; PA. STAT. (Purdon,

promise, and permit plaintiff to recover substantial damages if he can show that he is a "trader" or otherwise that the reputation of his credit is of peculiar value to him.[4] Under this latter view, one not a "trader" must prove specifically the injury to the reputation of his credit. This view follows the traditional idea of the common law. Under the usual theories of defamation, statements derogatory to the credit of a merchant or trader are slanderous *per se*.[5]

It appears to make little difference whether an action of this sort is instituted under a theory of defamation, or, as is more common, upon a theory of breach of implied contract between bank and depositor. The Mississippi Supreme Court in the present case declared the action fell under the implied contract theory. The court specifically rejected the proffered theory of "negligence" in order to avoid the reduction of damages on the ground of plaintiff's comparative negligence.

William H. Fedric

CONFLICT OF LAWS—CIVIL DEATH—APPLICATION OF STATUTE OF FORUM TO FOREIGN CONVICTION.

Plaintiff, who had been convicted and sentenced to life imprisonment by a Florida court, brings action for negligence in federal district court of New York. Statute of New York provided "A person sentenced to imprisonment for life is thereafter deemed civilly dead."[1] Defendant claims that plaintiff's sentence to life imprisonment in Florida would bring plaintiff within the purview of this statute, and that plaintiff was therefore civilly dead and could not maintain any action in New York. HELD: New York statute applies only to conviction in that state, and since plaintiff was convicted in Florida, he could not be civilly dead in New York. *Panko v. Endicott Johnson Corporation*, 24 Fed. Supp. 678 (N. Y. 1938).

At early common law, civil death was imposed upon a number of grounds, and worked a forfeiture of all political rights, property, and the right to sue.[2] In the absence of statute, American courts have generally refused to adopt the common law doctrine of civil death.[3] And statutes imposing disabilities or

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1936) Banks & Banking, § 211. The purpose of such statutes is to do away with the presumption of damages arising from non-payment and to limit recovery to such actual loss or injury as the depositor may be able to show.

[4]Mecrum v. Security Trust & Savings Co., 221 Ala. 419, 129 So. 74 (1930); McFall v. First Nat. Bank of Forrest City, 138 Ark. 370, 211 S. W. 919 (1919); Ward v. State Bank of Yates, 52 Mont. 328, 157 Pac. 573 (1916); Browning v. Bank of Vernal, 60 Utah 197, 207 Pac. 462 (1922).

[5]RESTATEMENT, TORTS (Tent. Draft No. 12, 1935) § 1013.

[1]N. Y. Cons. Laws (Cahill, 1930) c. 41, § 511.

[2]At early common law, strict civil death commenced on banishment from the realm, abjuration from the realm, or profession of religion. Such civil death was in its incidents equivalent to natural death. See Avery v. Everett, 110 N. Y. 317, 18 N. E. 148 (1888).

[3]Holmes v. King, 216 Ala. 412, 113 So. 274 (1927); Willingham v. King, 23 Fla. 478, 2 So. 851 (1887); Dade Coal Co. v. Haslett, 83 Ga. 549, 10 S. E. 435 (1889); Commonwealth v. Clemmer, 190 Pa. 202, 42 Atl. 675 (1899); Kenyon v. Saunders, 18 R. I. 590, 30 Atl. 470 (1894); State v. Duket, 90 Wis. 272, 63 N. W. 83 (1895). Mississippi has no statute imposing civil death, nor has there been a direct holding as to whether the common law doctrine is recognized. Would the following dictum in Branton v. Washington County,

disqualifications for conviction of crime have been generally held to apply only to a conviction in the forum, unless specific words are used to include foreign convictions.[4]

It would seem that a statute imposing civil death, *i. e.*, deprivation of right to sue, would present an analagous situation to those above mentioned, and would therefore be treated in the same manner. The court in the instant case was influenced by the belief that to apply the statute where conviction was made in another state would be giving extraterritorial affect to it. Actually there is no question of giving extraterritorial affect to a state statute, since the forum is faced solely with the problem of application of its *own* statute, which describes what parties will be allowed to sue in its own court.[5] If the court decides that the statute does not apply to an out-of-state conviction, it is doing no more than giving a strict, narrow construction to the words of the statute. And since the statute is distinctly penal in its nature, the court is giving the usual construction to statutes of this type.[6]

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79 Miss. 277, 283, 30 So. 659, 660 (1901) be an indication of the Mississippi view on this point: "Though convicted of crime, they are human beings, and are entitled to every right and consideration of any other person, except the loss of liberty and the imposition of hard labor upon them for a fixed period."?

[4]*Grounds for incompetency of witness*: Logan v. United States, 144 U. S. 263 (1892); Commonwealth v. Green, 17 Mass. 515 (1822); State v. Landrum, 127 Mo. App. 653, 106 S. W. 1111 (1908); Sims v. Sims, 75 N. Y. 466 (1878); National Trust Co. v. Gleason, 77 N. Y. 400 (1879); Weber v. State, 18 Okla. Cr. 421, 195 Pac. 510 (1921). *Contra*: State v. Foley, 15 Nev. 64 (1880); Chase v. Blodgett, 10 N. H. 22 (1838); State v. Chandler, 10 N. C. 393 (1824).

Grounds for disbarment of attorney: *In re* Ebbs, 150 N. C. 44, 63 S. E. 190 (1908); *In re* Elliott, 122 Okla. 180, 253 Pac. 103 (1927) (record of conviction in federal court sitting in Oklahoma held merely *evidence* tending to prove violation of duty). But *cf. In re* Kirby, 10 S. D. 414, 73 N. W. 907 (1898) (attorney disbarred without discussion for conviction in federal court sitting in same state).

Grounds for disqualifying one from holding public office: State *ex rel.* Mitchell v. McDonald, 164 Miss. 405, 145 So. 508 (1933). But *cf.* State v. Langer, 65 N. D. 68, 256 N. W. 377 (1934) (conviction in federal court sitting in state held to disqualify governor from holding office).

Grounds for disqualifying administrator or executor: *In re* Cohen's Will, 164 Misc. 98, 298 N. Y. Supp. 368 (Surr. Ct. 1937); Dunham v. Germain, 181 Okla. 407, 74 P. (2d) 117 (1937).

Grounds for divorce: Leonard v. Leonard, 151 Mass. 151, 23 N. E. 732 (1890); Daughdrill v. Daughdrill, 180 Miss. 589, 178 So. 106 (1938). *Contra*: Note (1936) 8 MISS. L. J. 493. It is perhaps a significant commentary upon the strict construction given by courts to these statutes that immediately after the decision in the Doughdrill case, the Mississippi Legislature changed the language of the statute from "*the* penitentiary" to "*any* penitentiary". Miss. Laws (1938) c. 264.

[5]Under statutes imposing civil death, courts of this country do not recognize the broad incidents of the common law doctrine [Avery v. Everett, 110 N. Y. 317, 18 N. E. 148 (1888)], and consequently such statutes should properly be classified as ones dealing with capacity to sue rather than status. In the instant case it was urged to the court that since the statute was one concerning capacity to sue, the law of the forum should control.

[6]BLACK, INTERPRETATION OF LAWS (2d ed. 1911) § 451; SUTHERLAND, STATUTORY CONSTRUCTION (Lewis' ed. 1904) §§ 520-27.

At common law civil death was a status, and therefore would appear to be controlled by the domicile of the party.[7] But even so, although the forum might possibly recognize the status created by the domicile,[8] it need not necessarily enforce all incidents of that status as recognized in the state of domicile. Also, if the statute is considered as one imposing additional punishment for the crime of which the plaintiff has been convicted, it would then be controlled by the state of conviction; but since no state enforces the penal or criminal statutes of another, it would have no effect in any other state.[9]

The court in the instant case evidently seemed not to be disturbed by an anomalous situation which might possibly be created under its holding. For under this decision, a person would be able to maintain suit in either his *domicile*, or in a strange *forum* as was the case here, when the statutes of the state of domicile, of conviction, and of the forum all agreed that a person convicted of such an offense is civilly dead and cannot maintain suit.[10]

L. A. Wyatt

CORPORATIONS — ESTOPPEL TO DENY CORPORATE EXISTENCE — CLAIM AS INDIVIDUAL TO BENEFITS OF CONTRACT ENTERED INTO BY WOMAN AS CORPORATION.

Defendant, a woman residing in Mississippi, under the name of the Tennessee Brokerage Co., Inc., sold a carload of hay to the plaintiff. The hay was shipped from Tennessee on a bill of lading with draft attached, drawn by the Tennessee Brokerage Co., Inc. through a bank at Clarksdale, Mississippi, on the plaintiff at the Bank of Ruleville, Ruleville, Mississippi. Plaintiff paid the draft and then discovered that the shipment was considerably short. He filed an attachment suit in a justice of the peace court at the domicile of the Ruleville Bank against the Tennessee Brokerage Co., Inc., as a non-resident corporation, and garnished the proceeds of the draft in the hands of the Bank of Ruleville. Defendant entered her appearance in the suit not as the defendant corporation but as claimant of the attached funds, and asserted that the amount of the draft belonged solely to her and that the corporation sued had no claim or title thereto. HELD: Claim disallowed. Having represented herself as a corporation and having transacted business as such, defendant is estopped to deny that she was the corporation originally sued. *Taylor v. Aldridge*, 180 Miss. 635, 178 So. 331 (1938).

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[7]DICEY, CONFLICT OF LAWS (5th ed. 1932) 27.

[8]2 BEALE, CONFLICT OF LAWS (1935) § 120.6. However in Wilson v. King, 59 Ark. 32, 26 S. W. 18 (1894), it seems that the court refused to recognize even the status, since it was held that in the absence of any statute, a conviction in a Tennessee court would not result in civil death in Arkansas.

[9]Logan v. United States, 144 U. S. 263 (1892); Commonwealth v. Green, 17 Mass. 515 (1822).

[10]Compare a similar anomalous holding in Harrison v. Moncravie, 264 Fed. 776 (C. C. A. 8th, 1920), where it was held that one convicted of murder in Kansas could inherit land in Oklahoma, although the law of both states was identical that a person cannot inherit from one he murders. In the instant case, the law of Florida [Willingham v. King, 23 Fla. 478, 2 So. 851 (1887)] was that civil death did not exist there. However, even if law of Florida (state of conviction) had been that plaintiff here was civilly dead, plaintiff under the present holding would still have been allowed to sue in New York, although the law of both states would seem to prohibit one so convicted from bringing suit. Perhaps if such a factual situation had been before the court, it would have reached a different conclusion.

The cases in which there have been attempts to set up the estoppel doctrine in regard to denials of corporate existence have usually been classified under one of the following divisions:[1] (1) cases in which the alleged corporation or one of its members is seeking to escape liability by alleging a defect in the organization;[2] (2) cases in which one party is seeking to evade liability to a corporate plaintiff by pleading irregularities in its organization;[3] (3) and cases in which the question is whether irregularities in organization will subject the associates to individual or partnership liability.[4] The principal case does not fall within any of the foregoing divisions. In it the attempt was not to deny liability on the ground that the corporation was non-existent but to enter the suit as a third party claimant rather than as the pretended corporation.

When plaintiff filed his attachment, the defendant had the option of entering the suit as the Tennessee Brokerage Corporation or of appearing as an individual claimant of the attached funds. Even if she was not attempting

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[1]BALLANTINE, PRIVATE CORPORATIONS (1927) § 27.

[2]It is only in this class of cases that the technical elements of equitable estoppel, *viz.*, misrepresentations and change of position in reliance thereon, can be found. If one contracts with an association which pretends to be a corporation he may sue the associates as a corporation and the principle of estoppel will prevent them from setting up the falsity of their representation as a defense. Lilylands Canal, *etc.*, Co. v. Wood, 56 Colo. 130, 136 Pac. 1026 (1913); Georgia Southern, Florida R. R. v. Merchantile Trust, *etc.*, Co., 94 Ga. 306, 21 S. E. 701 (1894); Fitzpatrick v. Rutter, 160 Ill. 282, 43 N. E. 392 (1895); Junction City Cent. Nat. Bank v. Sheldon, 86 Kan. 460, 121 Pac. 340 (1912) (estoppel of officers and directors of supposed corporation); Gardener v. Minneapolis & St. L. Ry., 73 Minn. 517, 76 N. W. 282 (1898) (estoppel of stockholders of supposed corporation).

But Boyce v. Towsontown Station M. E. Church, 46 Md. 359 (1877) denies the doctrine of estoppel of an acting corporation to deny its own existence, the court saying: "To permit parties indirectly, or upon the principle of estoppel, virtually to create a corporation for any purpose, would be in manifest opposition to the statute law, and clearly against its policy, and justified upon no sound principle in the administration of justice."

[3]The technical elements of estoppel are lacking here, but upon broader principles of contract and business convenience the doctrine is employed. If an association sues one who has contracted with it as a corporation, he cannot set up irregularities in the organization as a defense against its right to sue as a corporation. This group should also include cases where a plaintiff, having sued defendant as a corporation, attempts to plead corporate irregularities so as to prevent defense. Winget v. Quincy Bldg., *etc.*, Assn., 128 Ill. 67, 21 N. E. 12 (1889); Commercial Bank of Keokuk v. Pfeiffer, 108 N. Y. 242, 15 N. E. 311 (1888); Lynch v. Perryman, 29 Okla. 615, 119 Pac. 229 (1911); Swofford Bros. Dry Goods Co. v. Owen, 37 Okla. 616, 133 Pac. 193 (1913).

[4]Apparently the weight of authority is that where the attempt to comply with the incorporation law does not go far enough to create a corporation *de facto* the associates may be held to full liability on contracts authorized or ratified by them either as partners, or as principals. Harrill v. Davis, 168 Fed. 187 (C. C. A. 8th, 1909); Shields v. Clifton Hill Land Co., 94 Tenn. 123, 28 S. W. 668 (1894).

Though the elements necessary to raise an estoppel strictly so called are not present, yet there are cases which hold, in view of the fact that the plaintiff consented to contract with the association on a corporate basis that there is an implied contractual limitation of liability to such remedies as could be used if the associates possessed corporate character or capacity. Staver & Abbott Mfg. Co. v. Blake, 11 Mich. 282, 69 N. W. 508 (1896).

to take advantage of her own deception to avoid liability, the defendant was confronted with a perplexing problem in making her decision as to which alternative would advance her interests. Under the existing state of law, it would be difficult to decide what would be the proper means of procedure for presenting her case in court. Had she entered the suit as the corporation, the plaintiff might have defeated her cause with a denial of corporate existence. It is true that most courts hold that one who sues an alleged corporation as such thereby admits its incorporation and is estopped to deny its corporate existence.[5] But on the other hand, there are authorities which refuse to apply the estoppel doctrine against third parties dealing with a supposed corporation,[6] especially when there is no *de facto* organization.[7] Whether or not Mississippi would require *de facto* organization to raise an estoppel was a matter of conjecture, as there was no case decisive of the point at the time this case arose.[8] Influenced by this doubtful state of the law in Mississippi, a defendant might enter such a suit as claimant honestly believing that in making this selection of procedure she was choosing the best method of contesting the case on its merits.

It would seem that the nature of the defendant's motive when she entered the suit as a claimant should have determined whether or not the estoppel doctrine would be employed so as to dismiss her claim. If the defendant was attempting to obtain the entire amount of the attached funds without an adjudication of the issues involved in the plaintiff's case, her position should be regarded with as much disfavor as if she had pleaded the non-existence of the corporation as a bar to the plaintiff's suit.[9] This is probably the interpretation that the court put upon her actions, and there are circumstances justifying such a conclusion. If so, the decision of the court cannot be said to be unjust or incorrect.

However, it would seem that if the defendant was influenced to proceed as an individual claimant by *bona fide* doubt as to whether or not a denial of corporate existence might have a disadvantageous effect on her case, and if she made her claim not to avoid a litigation of the case on the merits but with the intention of defending the suit in her true capacity as a private individual, no beneficial purpose could be served by an application of the estoppel doctrine so as to disallow her claim. In fact a speedier and more satisfactory disposi-

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[5]This type of cases falls within the second division of the enumeration of the situations in which corporate estoppel is employed. People v. Stanford, 77 Cal. 360, 18 Pac. 85, 19 Pac. 693 (1888); Richmond County v. Richmond County Reformatory Inst., 141 Ga. 457, 81 S. E. 232 (1914).

[6]In Maryland Tube & Iron Works v. West End Imp. Co., 87 Md. 207, 39 Atl. 620 (1898); Welland Canal Co. v. Hathaway, 8 Wend. 480 (N. Y. 1832); and Eastern Products Corporation v. Tennessee Coal, Iron & Railroad Co., 151 Tenn. 239, 269 S. W. 4 (1925), persons who had dealt with corporations as such were afterwards allowed to deny their corporate existence.

[7]Jones v. Aspen Hardware Co., 21 Colo. 263, 40 Pac. 457 (1895) and National Shutter Bar Co. v. Zimmerman, 110 Md. 313, 73 Atl. 19 (1909) seem to limit the estoppel doctrine to cases in which there is a *de facto* corporation.

[8]Johnston v. Gumbel, 19 So. 100 (Miss. 1895) offers no assistance as the record showed the organization was at least a *de facto* corporation. But see Fargason v. Oxford Mercantile Co., 78 Miss. 65, 73, 27 So. 877, 879 (1900) wherein the court said, "Even if a concern should be carried on apparently as a corporation, without any charter at all, it cannot be that its creditors would be powerless to collect from it, or that it could not pay its debts."

[9]See *supra*, note 2. The same reasons for the application of the estoppel doctrine would exist.

tion could be made of the case, if the court would dismiss the suit as against the Tennessee Brokerage Corporation and continue it against the defendant as claimant. The plaintiff would not be inconvenienced, as the defendant would already be in court and the merits of the case could be as thoroughly litigated between the plaintiff and the supposed corporation. The argument is sometimes advanced in favor of the application of the estoppel doctrine that the contract with a supposed corporation embodies an implied term that it should be regarded as a corporation for the purpose of suit or for the purpose of preventing individual or partnership liability.[10] However, if the rights of the parties are unaffected and if the deceived party is not inconvenienced by a failure to apply the doctrine, there is no reason for upholding such a contention.

The estoppel doctrine is a device for rendering justice to the parties[11] and affording a speedy and efficient disposition of the cases.[12] It is not an instrument wherewith to penalize an organization or an individual for having falsely claimed to be a corporation.[13] Though a misrepresentation and an action in reliance thereon are properly elements of estoppel, they are not necessary prerequisites to an application of the doctrine so as to prevent a denial of corporate existence. Where procedural convenience and justice to the parties may be obtained thereby, the doctrine is applied though the above noted elements of estoppel are lacking. On the other hand, though deceptive claims of corporate character and subsequent actions in reliance thereupon are circumstances present in the case, the doctrine should not be employed where its application is not necessary to prevent injustice to one of the parties or to promote an efficient adjudication on the merits.

Mary Caruthers Gholson

USURY — "SERVICE CHARGE" IMPOSED BY BANK ON SMALL LOAN AS USURIOUS.

The Bank of Clarksdale held six notes of Dickey for $25 each, due, respectively, in a series of one to six months after date on which no interest as such was charged but a service charge of $1 each was collected at maturity. The interest represented by the service charge exceeded 8 per cent, the amount

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[10]In Staver & Abbott Mfg. Co. v. Blake, 11 Mich. 282, 69 N. W. 508 (1896), the court said: "The law does not permit *A* to deal and make contracts with *B* in one capacity, and then hold him liable in another. These defendants have never agreed to be partners, and have never held themselves out to plaintiff as such."

[11]In Lowell-Woodward Hardware Co. v. Woods, 104 Kan. 729, 180 Pac. 734 (1919) the court held that the estoppel doctrine was applicable because its employment "accords with modern views of good practice and tends to promote substantial justice".

[12]"The corporation by estoppel doctrine may be explained as being in part a rule of procedure, as to the right to sue or be sued in a common name; in part a rule of property, that title may be acquired and conveyed in a common name; in part a rule of contract, that the substantial rights of parties will be limited to what they bargained for; in part a rule of agency, that the associates gave no authority to officers to bind them personally." BALLANTINE, PRIVATE CORPORATIONS (1927) § 27, n. 62.

[13]The organization would not be penalized by a forfeiture of its benefits under a contract.

allowed by statute.[1] HELD: The notes were usurious. *Dickey v. Bank of Clarksdale*, 184 So. 314 (Miss. 1938).

To constitute usury it is essential that something in excess of the legal maximum be exacted in consideration of the loan or forbearance.[2] Where a contract for a loan provides for the rendition of services by the lender to the borrower, a fair charge for the services or additional consideration, together with the legal rate of interest on the money loaned, does not render the contract usurious.[3]

These charges are allowed if there is an agreement by the borrower to make good to the lender any loss resulting from changes made in his investments for the purpose of raising the money loaned.[4] They are also permitted when there are expenses incurred in procuring the money for the loan,[5] expenses of examining and appraising the security which he offers for a loan,[6] attorney's fees for collection of the note,[7] investigations of title and abstracts,[8] travelling expenses incurred in connection therewith,[9] and services in preparing, acknowledging and recording papers.[10] A provision that the borrower pay the taxes is upheld,[11] but courts are inclined to disagree as to taxes on the mortgage or the debt.[12] But if a lender exacts a bonus from the bor-

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[1]MISS. CODE ANN. (1930) § 1946.

[2]27 R. C. L. 223; Note (1937) 21 MINN. L. REV. 585. For a brief and interesting historical summary of the laws of usury, see Dunham v. Gould, 16 Johns. 367, 376 (N. Y. 1819).

[3]Shattuck v. Byford, 62 Ark. 431, 35 S. W. 1107 (1896); Iowa Savings & Loan Assn. v. Heidt, 107 Iowa 297, 77 N. W. 1050 (1899); Lassman v. Jacobson, 125 Minn. 218, 46 N. W. 350 (1914). But see Comm. v. Morris, 176 Mass. 19, 56 N. E. 896 (1900).

[4]Comstock v. Wilder, 61 Iowa 274, 16 N. W. 108 (1883); Snow v. Nye, 106 Mass. 413 (1871); Stevens v. Staples, 64 Minn. 3, 65 N. W. 959 (1896). Notes (1922) 21 A. L. R. 799, (1929) 63 A. L. R. 823, (1936) 105 A. L. R. 795, (1932) 10 N. C. L. REV. 403.

[5]Riker v. Clark, 54 Vt. 289 (1881) (expense incurred from payment of interest by the lender on a loan from a third person); Note ANN. CAS. 1914C 410.

[6]Richardson v. Shattuck, 57 Ark. 347, 21 S. W. 478 (1893); Stein v. Swensen, 44 Minn. 218, 46 N. W. 360 (1890); Lassman v. Jacobson, 125 Minn. 218, 46 N. W. 350 (1914); Notes (1914) 51 L. R. A. (N. S.) 465, ANN. CAS. 1915C, 774.

[7]Billingsley v. Dean, 11 Ind. 331 (1858); Smith v. Silvers, 32 Ind. 321 (1869); International Motor Co. v. Palmer, 92 Misc. 214, 155 N. Y. Supp. 357 (1915); Notes (1931) 6 TULANE L. REV. 149, L. R. A. 1915B 928.

[8]London Realty Co. v. Riodan, 207 N. Y. 264, 100 N. E. 800 (1913), *aff'd.* 148 App. Div. 854, 133 N. Y. Supp. 595 (1912).

[9]Matthews v. Ga. State Savings Assn., 132 Ark. 219, 200 S. W. 130 (1918); Smith v. Wolf, 55 Iowa 555, 8 N. W. 429 (1881).

[10]Rantala v. Haish, 132 Minn. 323, 156 N. W. 666 (1916); American Mortgage Co. v. Woodward, 83 S. C. 521, 65 S. E. 739 (1909).

[11]Kidder v. Vandersloot, 114 Ill. 133, 28 N. E. 460 (1885); Detroit v. Board of Assessors, 91 Mich. 78, 51 N. W. 787 (1892). *Contra*: Dawson County State Bank v. Temple, 116 Neb. 727, 218 N. W. 737 (1928). Some cases draw a distinction as to who has the legal title. Union Mortgage Bank & Trust Co. v. Hagood, 97 Fed. 360 (C. C. S. C. 1897); Dwyer v. Weyant, 116 Neb. 485, 218 N. W. 140 (1928); Notes (1926) 5 NEB. L. BULL. 431, (1928) 41 HARV. L. REV. 405.

[12]*Usurious*: Vandervelde v. Wilson, 176 Mich. 185, 142 N. W. 553 (1913); Meem v. Dulaney, 88 Va. 674, 14 S. E. 363 (1890). *Not Usurious*: Lassman v. Jacobson, 125 Minn. 218, 46 N. W. 350 (1914); Moore v. Lindsey, 61 Misc. 176, 114 N. Y. Supp. 684 (1908).

rower[13] or charges a *pro rata* share of the expenses of running the lender's business,[14] beyond the legal interest, the transaction is usurious.[15] The charges are permitted where the expenses have been incurred[16] or are anticipated.[17]

Even where the lender has contracted to do certain things for the borrower in consideration of additional compensation, the contract is not rendered usurious by the circumstances that the borrower later voluntarily elects to perform those services himself.[18] The lender, standing ready to perform his undertaking, is entitled to the compensation.[19]

If the lender is a commission merchant, he may charge a reasonable commission for accepting bills of a customer and providing funds for meeting them. This is a compensation for the service rendered in lending his credit and raising money to meet the debt of another.[20] In situations where the loan is the result of negotiations through the medium of an agent of the lender, and such agent exacts a commission from the borrower, the loan is not necessarily usurious, although the total amount paid is more than the legal limit, unless it can be shown that the lender authorized or ratified the acts of such agent.[21] Where there is an authorization or ratification, or acts implying as much, and where the total amount paid by the borrower exceeds the maximum legal rate, the transaction is usurious.[22] However, where the

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[13]Smith v. Parsons, 55 Minn. 520, 57 N. W. 311 (1893) (bonus plus services rendered to lender by the borrower); Rantala v. Haish, 132 Minn. 323, 156 N. W. 666 (1916) (bonus brought the interest paid on loan of $300 for 5 years to $7 more than the rate allowed by statute); Clark Co. v. Warner Co., 188 Minn. 277, 247 N. W. 225 (1933) (bonus of shares of stock); Citizens State Bank of St. Paul v. Wade, 165 Minn. 396, 206 N. W. 728 (1925) (liberty bonds given as a bonus); Widell v. Nat. Citizen's Bank of Mankato, 104 Minn. 510, 116 N. W. 919 (1908) (additional note for $5,000 for alleged services); Phelps v. Montgomery, 60 Minn. 303, 62 N. W. 260 (1895) (50 shares of stock given as bonus).

[14]Joy v. Provident Loan Soc., 37 S. W. (2d) 254 (Tex. Civ. App. 1931); Comment (1931) 10 TEX. L. REV. 118.

[15]Hewitt v. Dement, 57 Ill. 500 (1873); Walter v. Foutz, 52 Md. 147 (1879); Harris v. Wicks, 28 Wis. 198 (1875).

[16]Matthews v. Ga. State Savings Assn., 132 Ark. 219, 200 S. W. 130 (1918); Blanchard v. Hoffman, 154 Minn. 525, 192 N. W. 352 (1923).

[17]Comstock v. Wilder, 61 Iowa 274, 16 N. W. 108 (1883); Daley v. Minn. Loan & Investment Co., 43 Minn. 517, 45 N. W. 1100 (1890).

[18]Matthews v. Coe, 70 N. Y. 239 (1877) (contract not usurious where commission merchant advanced money to a dealer to enable latter to buy produce which former was to manage and sell for a percentage of the amount advanced though dealer voluntarily took charge of and managed the produce himself.)

[19]Cockle v. Flack, 93 U. S. 344 (1877); Norwood v. Faulker, 22 S. C. 367 (1884).

[20]Harmon v. Lehman, 85 Ala. 379, 5 So. 197 (1888); Trotter v. Curtis, 19 Johns. 160 (N. Y. 1886). *Held usurious*: Whitt v. Ky. Oil Co., 223 Ky. 348, 3 S. W. (2d) 786 (1928); Webb v. Southern Trust Co., 227 Ky. 79, 11 S. W. (2d) 988 (1928).

[21]Acheson v. Chase, 28 Minn. 211, 9 N. W. 734 (1881) (the taking of bonus by agent held unauthorized); Mackey v. Winkler, 35 Minn. 513, 29 N. W. 337 (1886) (commission taken by lender's agent who acted without compensation from lender, held not to render the loan usurious where it did not appear that the commission was unreasonable or excessive in view of the services rendered); Lewis v. Willoughby, 43 Minn. 307, 45 N. W. 439 (1890); Blackey v. Alexander, 156 Minn. 478, 195 N. W. 455 (1923); Comment (1929) 14 MINN. L. REV. 195.

[22]Adamson v. Wiggins, 45 Minn. 448, 48 N. W. 185 (1891); Carpenter v.

borrower pays a bonus or commission to his own agent as compensation for services rendered in securing a loan, there can be no justification for a claim of usury, notwithstanding the fact that the borrower pays, in addition, the highest legal rate of interest.[23]

The decisive test seems to be whether the extra charge was intended in good faith as compensation for services or expenses supplied by the lender in connection with the making of the loan, or as a subterfuge for a usurious contract.[24] The courts will scrutinize the charge with care, if suspicious, with the view of determining its true character.[25]

While the rule of the instant case may tend to restrict the "loan shark racket", it at the same time makes it impossible for the banks to lend money in small sums, and thus the hardship is placed on the portion of the public desiring small loans. It has become a universal custom for banks to make service charges on small loans, justified by the fact that the expense of making these small loans cannot be covered by the legal rate of interest. Though no custom can legalize a usurious contract,[26] a prevailing custom will influence the decision of a court and may aid in the interpretation of what the words of a statute actually mean.

The abuse of the service charge has in some instances occasioned legislative action, notably in the field of small loans.[27] Thus, many states have enacted the Uniform Small Loan Law,[28] providing for a fair return to one who lends $300 or less without the necessity of resorting to the subterfuge of service charges, which are allowed under no pretext. This Act, drafted in 1916, has become the basis of existing legislation in a number of states; there are 31 states which now have legislation on the subject.[29]

Such a law authorizes a charge not to exceed 3½% a month on loans not to exceed $300 in amount. The business is confined to licensees, who are thus under a degree of public control. Along the same line but applying to any size of loan, except as limited by the amount of the bank's capital, is a system by which a service charge is made on a graduated scale according to the amount of the loan.[30] The results reached by these systems are similar,

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Lamphere, 70 Minn. 542, 73 N. W. 514 (1897); Clark Co. v. Warner Co., 188 Minn. 277, 247 N. W. 225 (1933).

[23]Bovee v. Butters, 92 Minn. 149, 99 N. W. 641 (1904); Hobart v. Michaud, 174 Minn. 474, 219 N. W. 878 (1928); Hatcher v. Union Trust Co. of Maryland, 174 Minn. 241, 219 N. W. 76 (1928).

[24]Beckwith v. Windsor Mfg. Co., 14 Conn. 593, 604-05 (1842); Brown v. Robinson, 224 N. Y. 301, 314-15, 120 N. E. 694 (1918).

[25]Harmon v. Lehman, 85 Ala. 379, 5 So. 197 (1888).

[26]Merchant's Bank v. Sarratt, 77 S. C. 141, 57 S. E. 621 (1905); 27 R. C. L. 224.

[27]Note (1931) 10 TENN. L. REV. 54-56.

[28]For a consideration of the Small Loan Law see Notes (1928) 14 A. B. A. J. 581, (1923) 23 COL. L. REV. 484, (1930) 14 MINN. L. REV. 410, (1935) 99 A. L. R. 923; HUBACHEK, ANNOTATIONS ON SMALL LOAN LAWS (1938) *passim*.

[29]For citations to all of the statutes in the various states, see HUBACHEK, ANNOTATIONS ON SMALL LOAN LAWS (1938). This work also collects the cases construing the statutes.

[30]". . . . and the bank shall have power to charge for a loan made pursuant to this section, one dollar for each fifty dollars or fraction thereof loaned for expenses, including any examination or investigation of the character and circumstances of the borrower, co-maker, or surety and for drawing and

but until our legislature adopts one of them we must reach the desired results through out court decisions.

Edgar J. Stephens, Jr.

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taking acknowledgments of necessary papers or other expenses incurred in making the loan, no charge shall be collected unless a loan shall have been made and in no case shall such charge exceed fifteen dollars." MICH. COMP. LAWS (1929) § 11927.

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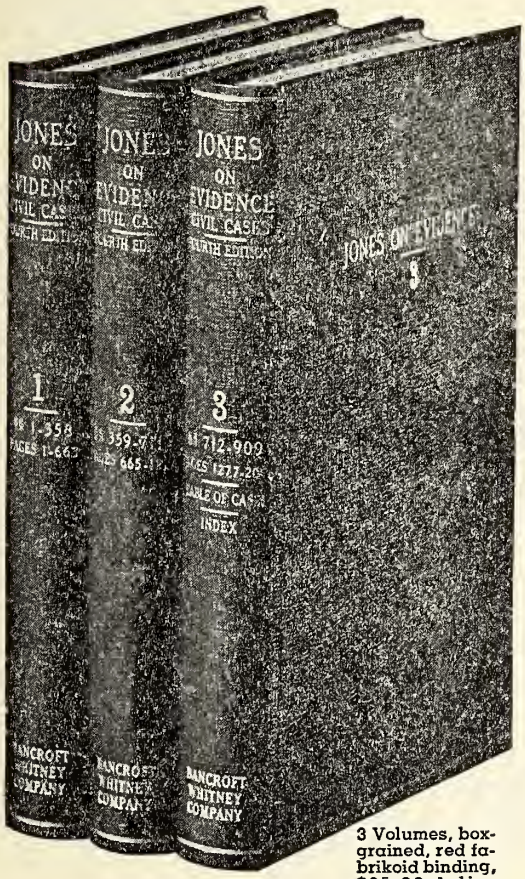

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